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NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

THESIS

**EVALUATION OF SUSTAINED VALUE CREATION WITH
THE DOD'S FINANCIAL IMPROVEMENT AND AUDIT
READINESS (FIAR) PLAN**

By

Robert David Patton

December 2006

Thesis Co-Advisors:

Douglas A. Brook
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**EVALUATION OF SUSTAINED VALUE CREATION WITH THE DoD'S
FINANCIAL IMPROVEMENT AND AUDIT READINESS (FIAR) PLAN**

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Submitted in partial fulfillment of the
requirements for the degree of

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ABSTRACT

For over two decades Congress has made several efforts aimed at improving financial visibility throughout the federal government. Responses from Department of Defense (DoD) have been criticized by Congress for not meeting requirements. In December 2005, the DoD released the Financial Improvement and Audit Readiness (FIAR) Plan. This plan is intended to integrate the individual efforts by DoD agencies into a coherent and comprehensive plan which aims to improve financial management within the Department, address Congressional mandates, and pass independent verification through audit. This analysis seeks to address two questions. Does the FIAR Plan create value through the integration of politics, substance, and administration? If so, can this change effort be sustained over the long-term? Previously published academic frameworks for evaluating public sector organizations will be used for each question. Benefits of this study will identify elements of value created by the FIAR Plan and recommendations improving perceived benefits to stakeholders. Second, it will provide an assessment of the risks to sustaining the change processes required of the FIAR Plan and provide recommendations for focus to high risk areas.

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TABLE OF CONTENTS

I.	INTRODUCTION.....	1
A.	BACKGROUND	1
B.	SCOPE AND OBJECTIVE.....	2
C.	METHODOLOGY	3
D.	ORGANIZATION.....	4
E.	ACCOUNTING DEFINITIONS	5
	1. Accounting Types.....	5
	2. Audits	6
II.	HISTORICAL BACKGROUND	7
A.	FINANCIAL MANAGEMENT UP TO THE 1990'S.....	7
B.	THE 1990'S AND CONGRESSIONAL LEGISLATION.....	9
	1. The Chief Financial Officers Act of 1990	10
	2. The Government Performance and Results Act of 1993	12
	3. The Government Management and Reform Act of 1994.....	13
	4. The Federal Financial Management Improvement Act of 1996.....	13
C.	DEPARTMENT OF DEFENSE RESPONSE	15
	1. The Friedman Report.....	16
	2. The Business Management Modernization Program (BMMP)	18
	3. The Business Transformation Agency	19
	4. A Need for A Plan	20
III.	DOD'S FIAR PLAN.....	21
A.	THE PLAN FORMATION	21
	1. Rationale.....	21
	2. Organization.....	22
	3. FIAR Plan Goals.....	25
B.	THE PROCESS.....	27
	1. AUDIT PROCESS	27
	2. Material Weaknesses.....	29
	3. Focus Areas	30
	4. Audit Strategy	31
	5. FIAR Planning Tool.....	33
C.	PROGRESS	33
D.	CONCLUSION	36
IV.	FIAR PLAN VALUE CREATION	37
A.	VALUE	37
B.	THE MOORE MODEL FOR PUBLIC VALUE	38
C.	APPLICATION OF THE MOORE MODEL.....	42
D.	EXAMINING VALUE FOR STAKEHOLDERS.....	45
	1. Up – Political	45

2.	Out – Substance	50
3.	Down – Administration.....	56
E.	CONCLUSION	58
V.	FIAR PLAN SUSTAINABILITY	61
A.	RATIONALE FOR EXAMINING SUSTAINABILITY	61
B.	THE FERNANDEZ/RAINEY MODEL.....	61
C.	BROOK STUDY OF FEDERAL GOVERNMENT AUDITED FINANCIAL STATEMENTS.....	65
D.	FIAR PLAN SUSTAINABILITY RISK ASSESSMENT.....	66
1.	Ensure the Need – Medium Risk	67
2.	Provide a Plan – Low Risk	69
3.	Build Internal Support – Medium Risk	70
4.	Top Management Support – High Risk	71
5.	Build External Support – High Risk	73
6.	Providing Resources – Medium Risk.....	75
7.	Institutionalize Change – Medium Risk.....	76
8.	Pursue Comprehensive Change – Medium Risk.....	77
E.	CONCLUSION	77
VI.	SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS FOR FURTHER STUDY	79
A.	SUMMARY	79
B.	CONCLUSIONS.....	80
C.	RECOMMENDATIONS FOR FURTHER STUDY	83
	LIST OF REFERENCES.....	87
	FURTHER READING	91
	INITIAL DISTRIBUTION LIST	93

LIST OF FIGURES

Figure 2-1.	CFO Act Agencies Not in FFMIA Compliance	15
Figure 3-1.	USD (Comptroller) Organization.....	23
Figure 3-2.	FIAR Plan Relationships With BEA and Components	24
Figure 3-3.	FIAR Plan KMP Example	28
Figure 3-4.	FIAR Projections for Assets.....	34
Figure 3-5.	Projections for Liabilities.....	35
Figure 4-1.	Basic Model of Public Organization Stakeholders	39
Figure 4-2.	Moore Model Traditional Interactions	40
Figure 4-3.	Moore Model Ideal Interactions	41
Figure 4-4.	Application of Moore Model to DoD FM.....	43
Figure 4-5.	Complete DoD FM Model Showing Exterior Links.....	45
Figure 4-6.	FIAR Projections for Assets.....	50

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LIST OF TABLES

Table 5-1.	FIAR Plan Sustainability Scorecard.....	67
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GLOSSARY OF ACRONYMS

BEA	Business Enterprise Architecture
BEP	Business Enterprise Priority
BMMP	Business Management Modernization Program
BTA	Business Transformation Agency
CBO	Congressional Budget Office
CFO	Chief Financial Officer
CFO Act	Chief Financial Officers Act of 1990
DCFO	Deputy Chief Financial Officer
DEAMS	Defense Enterprise Accounting Management System
DepSecDef	Deputy Secretary of Defense
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DoD	Department of Defense
DoD IG	Department of Defense Inspector General
ERP	Enterprise Resource Plan
ETP	Enterprise Transition Planning
FASAB	Federal Accounting Standards Advisory Board
FFMIA	Federal Financial Management Improvement Act
FEMA	Federal Emergency Management Agency
FIAR	Financial Improvement and Audit Readiness
FIAR-PT	FIAR Planning Tool
FIP	Financial Improvement Plan
FM	Financial Management
FMFIA	Federal Managers' Financial Integrity Act
FMMP	Financial Management Modernization Program
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards

GAO	Government Accountability Office
GFEBs	General Fund Enterprise Business System
GMRA	Government Management and Reform Act
GPRA	Government Performance and Results Act
IG	Inspector General
KMP	Key Milestone Plan
NAE	Naval Aviation Enterprise
OM&S	Operating Materials and Supplies
OMB	Office of Management and Budget
OUSD(AT&L)	Office Under Secretary of Defense (Acquisition, Technology and Logistics)
PDI	Professional Development Institute
PMA	President's Management Agenda
PP&E	Property, Plant and Equipment
PPBES	Planning, Programming, Budget and Execution System
QDR	Quadrennial Defense Review
SecDef	Secretary of Defense
SFIS	Standard Financial Information Structure
USD(C)	Under Secretary of Defense (Comptroller)
USSGL	United States Standard General Ledger

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EXECUTIVE SUMMARY

Financial management reform has been an issue the Department of Defense (DoD) has struggled with for many years. Congress has attempted to obtain better visibility of the government's financial position through a series of laws and mandates. These laws included the:

- Federal Managers' Financial Integrity Act (FMFIA) of 1982;
- Chief Financial Officers (CFO) Act of 1990;
- Government Performance and Results Act (GPRA) of 1993;
- Government Management and Reform Act (GMRA) of 1994;
- Federal Financial Management Improvement Act (FFMIA) of 1996.

This series of laws defines the current requirement for the production of business-like financial statements and reports, which represent the federal agency's financial position and performance. Furthermore, they must be verified by an independent audit.

Since the passage of the CFO Act most of the federal agencies required to do so have been able to produce financial statements backed up with unqualified opinions from auditors. The DoD has not been one of them. The DoD and most of its component agencies (such as the Army, Navy, and Air Force) have received only disclaimed opinions on their audits. Stated simply, the financial information produced by the Department and its agencies cannot be verified to be reliable or accurate and calls into question the management of financial resources.

Efforts were made by the DoD to correct the discrepancies in its financial systems and internal control in order to obtain an unqualified opinion on the audits. Most of these early efforts had the DoD components attempting to solve their problems on their own. In 2002 the Financial Management Modernization Program (FMMP) was started to aid in the coordination of improvement programs. This evolved into the Business Management Modernization Program (BMMP) and finally into the Business Transformation Agency (BTA) in 2006.

The problems with financial systems throughout the DoD turned out to be much larger and complex than originally thought. By December 2005 a new plan was released by the DoD to coordinate the efforts of the various components and set the roadmap for the Department to improve its financial infrastructure and achieve an unqualified opinion on its financial statements. This is the Financial Improvement and Audit Readiness (FIAR) Plan. The FIAR Plan supports the Financial Visibility transformation goals under the Enterprise Transition Plan (ETP). The first release of the Plan was in December 2005. There have been updates released in June and September 2006.

The FIAR Plan is administered by the FIAR Directorate, which resides in the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)), under the Deputy CFO. Strategic goals and focus areas are set by the FIAR Committee. It is chaired by the DCFO, and has representation from USD(C), the Military Departments, Defense Logistics Agency (DLA), Defense Finance and Accounting Service (DFAS), and the BTA.

Execution of the FIAR Plan is accomplished through the individual component Financial Improvement Plans (FIPs). Intermediate line-item goals are known as Key Milestone Plans (KMPs). Financial improvements are focused on the following capabilities:

- Forecast, plan, program, and budget;
- Manage financial assets and liabilities;
- Funds allocation, collection, disbursement, and control;
- Manage general ledger;
- Managerial accounting;
- Financial reporting.

Focus Areas are set by the FIAR Committee. Areas are chosen for their material impact on the balance sheet. Currently they are: Military Equipment, Real Property, Medicare-Eligible Retiree Health Care Fund, Environmental Liabilities, Operating Materials and Supplies, Accounts Payable, Account

Receivable. In addition to the Focus Areas, four Priority areas were added: Fund Balance with Treasury, U.S. Marine Corps, Military Pay, and Military Obligations.

The FIAR Plan also established a process monitored by the FIAR Directorate for components to get an assertion for audits. This is a five-step process.

1. Discovery and correction
2. Validation
3. Assertion
4. Assessment
5. Audit

Projection for completion of component audits is 2017 as of the September 2006 release of the FIAR Plan.

A fundamental question that arises from this plan is; does such a plan create value for the various stakeholders in and around the Department? To examine this, a framework developed by Mark Moore of the Harvard Business School was chosen to focus on value creation from a public organization. The Moore Model recognizes that there are various stakeholders which exert different forces upon public organizations for different reasons. He simplifies the model by categorizing stakeholders into three distinct directions; up, out, and down. Visualizing the manager in the center, he must provide value upward as defined by the political system which provides the mandates and resources to perform functions. He must provide value outward by providing results which the public defines as valuable. He must provide value downward into the organization by effectively managing its operations. Thus, value creation is derived from the integration of politics, substance, and administration.

Using this model it was determined that the FIAR Plan does achieve this integration. Summing the findings of value creation:

- Up – It sets the roadmap for compliance with Congressional mandates. It also tracks milestones to demonstrate that progress is being made. The FIAR Plan has been viewed as a positive step by Congress, the GAO, DoD IG, and OMB.
- Out – For the public the FIAR Plan provides a visible demonstration that the DoD is working to improve its financial systems. Eventually, with the unqualified opinion, it will provide an independent assessment that financial processes are working well. The value created is improved confidence in the conduct of the organization. Thus, the auditor's opinion on the financial statements is important. For the DoD components, the financial improvements made will improve the information used for decision making.
- Down – The FIAR Plan adds value for the financial management community by providing a common framework from which to make their improvements. Accountability is more visible across the components with the use of the FIAR Planning Tool and reporting. It also provides the systematic process for preparing for audit.

While the FIAR Plan does create the value, as stated above, there are items that could be better enhanced within the FIAR Plan in order to realize potential further benefits. These are:

- Working with political leadership to take advantage of future financial visibility;
- Improved visibility to changes in the Plan so overseers have less reason to question the sincerity or execution of the Plan;
- Seeking progress metrics that non-financial managers can understand and appreciate;
- Make the relevance of financial information just as important as the timeliness, accuracy, and reliability of it;
- Including the transformation of financial managers as people to handle the transformation of systems and processes.

A second fundamental question that arises is; if the FIAR Plan creates value, then is it a strategy that can be sustained over the long-term? To address this a second framework was chosen which was developed by Sergio Fernandez of Indiana University and Hal Rainey of the University of Georgia. They derived eight factors for successful change processes within public organizations. The eight success factors are:

- Ensure top management commitment;
- Build external support;
- Ensure the need;
- Build internal support;
- Provide resources;
- Institutionalize change;
- Pursue comprehensive change;
- Provide a plan.

The factors were used to evaluate the environment under which the FIAR Plan is being implemented by applying a risk analysis. Findings indicate that top management support and external support are high risk areas. This is due to the questionable support from non-politically appointed leadership, especially from those with non-financial backgrounds. Additionally, with the upcoming elections in 2008 there is no guarantee that the next administration will have the same priority with regard to financial reform. The effects of the recent 2006 Congressional election are uncertain. Without support from the current civilian and military leadership, the risk of a priority shift increases.

The next five factors were medium risk areas. The FIAR Plan's inclusion of component FIPs helps to ensure support from within and encourage the changes required. But it does risk reprioritization at the component level which could upset the Plan at the macro level.

Using another study by Douglas Brook it was determined that support of top management, internal support, external support, and the provision of resources are the most critical elements. Efforts focused in these areas would likely have the greatest impact on sustainability. Additionally, these factors require that a focus on people is critical for sustained changes to succeed.

It is worth noting that these two elements, value and sustainability, are mutually supportive. Those activities which create value will promote sustainment. Likewise, those activities which ensure sustainment will increase value. This correlation can also be applied to the two models used for this

analysis. Moore's UP direction (Political System) matches to the Fernandez/Rainey factors of ensuring the need, external support, comprehensive change and provision of resources. Value created in this direction will aid DoD FM increased political legitimacy and financial support. Interactive involvement with political authorizers can be critical to long-term success as was seen with the New Zealand government's change in accounting systems.

Moore's OUT direction (Receivers and Payers of Services) aligns with the Fernandez/Rainey factors of ensuring the need, external support and comprehensive change. It is worth noting again that the root of value is in the perceived desires of the individual. A successful plan requires having knowledge of what value needs to be created before making the change. An understanding of how these stakeholders use financial information is critical to providing the right value. With that, support will follow.

Moore's DOWN direction (Organization) aligns with the Fernandez/Rainey factors of ensuring the need, providing a plan, internal support, top management support, institutionalize change and comprehensive change. What becomes clearer when combining the two models in this direction is the importance of the human element in creating value and sustained change. Achieving the value potential UP and OUT requires the organization to make sustained changes within itself. This is as much a leadership and education challenge as it is a system and process challenge.

To summarize, the FIAR Plan is a comprehensive change strategy that does create value for DoD stakeholders. However, there is potential for greater value creation by greater focus on the perceived desires and expectations of those stakeholders. The FIAR Plan appears to be at high risk for long-term success mainly due to questionable buy-in from civilian and military leaders, along with an uncertain political environment. Efforts should be focused on inclusion of a human capital strategy to supplement the FIAR Plan focus on financial systems and processes, and securing the support for FIAR Plan objectives from civilian and military leadership.

I. INTRODUCTION

A. BACKGROUND

Financial management reform has been an issue the Department of Defense (DoD) has struggled with for many years. Congress, in its oversight role of federal programs, has attempted to obtain better visibility of the government's financial position through a series of laws and mandates designed to improve the accountability and management of appropriated resources. During the 1990s, a string of laws was passed and signed which further defined what Congress wanted; the production of business-like financial statements and reports which represented the federal agency's financial position and performance, verified by an independent audit.

Since the passage of the Chief Financial Officers Act (CFO Act) in 1990, most of the federal agencies required to do so have been able to produce financial statements backed up with unqualified opinions from auditors. The DoD has not been one of them. For the last 12 years the DoD and most of its component agencies (such as the Army, Navy, and Air Force) have received disclaimed opinions on their audits. Stated simply, the financial information produced by the Department and its agencies cannot be verified to be reliable or accurate.

Efforts have been made by the DoD to correct the discrepancies in its financial systems and internal control in order to obtain an unqualified opinion on the audits. Most of these early efforts had the DoD components attempting to solve their problems on their own. This did not work. The problems with financial systems throughout the DoD turned out to be much larger and complex than originally thought. By December 2005 a new plan was released by the DoD to coordinate the efforts of the various components and set the roadmap for the Department to improve its financial infrastructure and achieve an unqualified opinion on its financial statements. This is the Financial Improvement and Audit Readiness (FIAR) Plan, and the subject of this study.

B. SCOPE AND OBJECTIVE

The overall objective of this analysis was to examine two major questions with relation to the FIAR Plan. The first, does the FIAR Plan create value, in the sense that it helps to meet desires and expectations of stakeholders concerned? Second, if it does create value, then can the changes required of the FIAR Plan be sustained over the long-term? This was a qualitative analysis based on historical documents, opinion papers, academic research, and interviews.

The FIAR Plan is a relatively new approach to helping solve what has become a prolonged problem. The intent of this analysis was to do two things. First, provide a look at the program from an academic perspective which may highlight issues in a different way for the reader. It is hoped this will stimulate further thought and discussion. Second, provide a foundation for further study of financial management reform and business transformation issues within the DoD. Benefits of this study include the identification of value elements created by the FIAR Plan and recommendations for improving perceived benefits to stakeholders. Second, it provides an assessment of the risks to sustaining the change processes required of the FIAR Plan and provides recommendations for focus to high risk areas.

This research was to make a careful examination of what the FIAR Plan is and its potential impacts at the macro level. Financial management within the DoD is very complex with an enormous amount of moving parts. Detailed analysis of specific line items within the FIAR Plan was beyond the scope of this research. Additionally, as will be explained in Chapter III, the FIAR Plan is reliant on financial improvement programs run by the individual DoD components to perform the execution of the plan. Analysis of those plans was also beyond the scope of this research.

There are 19 different agencies within the DoD that are required to produce auditable financial statements. Research into the DoD components was focused on the three major agencies (Army, Navy, and Air Force) which together are responsible for over 80% of the DoD's yearly budget.

C. METHODOLOGY

The methodology of work began with a background discussion of the legislation, regulations, and issues which led up to the development of the FIAR Plan. Included is a detailed discussion of the FIAR Plan's organization, goals, methodology, and progress to date.

Two frameworks were applied to the FIAR Plan in this study to examine to the two main questions. The Moore Public Value framework was used to address the first question concerning the value of the Plan. It is a framework based on public institutions and the forces which act upon the managers as they attempt to create value for the various stakeholders of the organization. A detailed description of the framework precedes analysis. That is followed by an application of the model to the DoD Financial Management (FM) community so as to assess the value creation for the various stakeholders by the FIAR Plan.

The second framework, the Fernandez/Rainey Success Factors for Change, was used to address the sustainability of the change process required of the FIAR Plan. This framework is also geared for application to public organizations. A detailed description precedes analysis. The model establishes eight significant factors to the success of a change process within a public organization. This study applied those factors to the environment the FIAR Plan operates in, to generate a risk assessment of the long-term success of the plan.

Data used for this study were obtained through numerous sources. These included academic works related to Defense financial management, governance, politics, change theories, organizational behavior, and strategic thinking. Data were also collected from reports released by the Government Accountability Office (GAO) and the Department of Defense Inspector General (DoD IG), as well as numerous articles from professional periodicals and newspapers.

One trip was conducted to San Diego to attend the 2006 Professional Development Institute (PDI) Conference sponsored by the American Society of Military Comptrollers (ASMC). Data were collected through attending numerous briefs and lectures related to the FIAR Plan and other transformation efforts throughout the DoD.

Interviews were conducted via phone and e-mail with several high-level financial managers at the Pentagon who are involved directly with implementation the FIAR Plan. These managers represented the Army, Navy, and Air Force offices for financial management. An attempt was made to interview someone involved with the FIAR Directorate, but there was no response. To promote a candid discussion of the environment in which the respondents work, anonymity was granted for their responses, and they will not be cited directly.

D. ORGANIZATION

This analysis begins in Chapter II with a review of the historical legislation and regulations which led up to the creation of the FIAR Plan. This includes the major Congressional legislation which applies to almost all of the federal agencies. There is also a review of some of the programs that the DoD undertook to achieve compliance prior to the FIAR Plan.

Chapter III provides a detailed overview of the FIAR Plan itself. There is a description of how it organized and how it relates to the bigger transformation efforts currently underway within the DoD. The goals of the Plan are discussed, as well as its methodology and progress since its release.

Chapter IV evaluates the first major issue, value creation. An overview of the Moore framework is provided. That is followed by an application to the FIAR Plan. Finally, there is discussion of the value created by the Plan in relation to the model.

Chapter V presents the second major issue, sustainability of the FIAR Plan. An overview of the Fernandez/Rainey framework is provided. That is followed by a risk assessment of the FIAR Plan's sustainability based on the framework's success factors. A detailed discussion of the rationale behind the assessment follows.

Chapter VI presents a summary of conclusions from the analysis. This section also provides recommendations for further study based on the research and findings.

E. ACCOUNTING DEFINITIONS

Much of the subject matter in this study deals with issues that relate to accounting. Accounting has its own language with terms that may be unfamiliar to the reader. The following are some basic terms that will be referred to in the report.

1. Accounting Types

There are three types of accounting to consider when talking about financial management in the DoD. They are Budgetary Accounting, Financial Accounting, and Managerial Accounting.

Budgetary accounting is used almost exclusively by government agencies. It is not used in the private sector. It supports the process of budget formulation and execution. The purpose of this system is to ensure compliance with budget law. It accounts for funds being spent on what was intended by legislators (purpose), within a designated period (time), and within fiscal constraints (amount).¹ The focus is on ensuring the transactions conform to purpose, time, and amount. Not necessarily on the product or service being bought.

Financial accounting is the system used in the private sector. In the government sector this is often referred to as *proprietary accounting*. This is the system used to produce financial statements. It follows strict rules called Generally Accepted Accounting Principles (GAAP). Its focus is on the accurate and reliable recording and presentation of historical events.² It accounts for assets, liabilities and cash flows. Financial accounting uses an accrual basis where revenue is recognized when realized, and expenses are recognized when incurred.³ The purpose is to provide accurate, reliable, and timely visibility to the organization's financial position.

Managerial accounting is for internal use to the organization. Its information is not intended for external users. Thus, there are no set rules. But,

¹ Phillip J. Candreva, "Accounting for Transformation" in *The Armed Forces Comptroller*. (Fall 2004) 9.

² Ibid., 8.

³ Charles H. Gibson, *Financial Reporting Analysis: Using Financial Accounting Information*, 10th Ed (Thomson South-Western: 2007) 18.

there are established standards and techniques which management can employ. The focus of managerial accounting is on providing information for management decisions and monitoring internal controls.⁴ Managerial accounting is also called *cost accounting*.

For the DoD, all three types of accounting are used. The primary type, and the one most familiar to users within the Department, is budgetary. Proprietary accounting is required to produce the financial statements, and is less established in the DoD accounting culture, as is managerial accounting.

2. Audits

Audits are independent examinations of an organization's accounting information. The responsibility of producing the financial statements rests with the organization's management. The auditor's job is just to render an opinion as to whether the statements fairly represent the organization's financial position and are in conformance with GAAP. Auditors must follow a set of rules known as Generally Accepted Government Auditing Standards (GAGAS). There are four opinions that can be rendered by the auditor.

- *Unqualified* – Also referred to as a “*clean*” *opinion*. This states that the financial statements represent fairly in all material respects, the financial position of the organization and are in keeping with GAAP.
- *Qualified* – This states that, except for the effect of matters pertaining to qualifiers, the financial statements represent fairly in all material respects, the financial position of the organization and are in keeping with GAAP.
- *Disclaimer of opinion* – Also known as a *disclaimed opinion*. This states that the auditor cannot express an opinion on the financial statements. This is rendered when the scope of the audit is not sufficient to provide enough information to make an opinion.
- *Adverse* – This states that the financial statements *do not* represent fairly the financial position of the organization due to nonconformance with GAAP.⁵

⁴ Phillip J. Candreva, “Accounting for Transformation” in *The Armed Forces Comptroller*. (Fall 2004) 9.

⁵ Charles H. Gibson, *Financial Reporting Analysis: Using Financial Accounting Information*, 10th Ed (Thomson South-Western: 2007) 50.

II. HISTORICAL BACKGROUND

A. FINANCIAL MANAGEMENT UP TO THE 1990'S

Financial management in the Federal Government has been a major issue for national leaders and the public since the early days of the Republic. Thomas Jefferson made a prophetic statement to his Secretary of Treasury, Albert Gallatin, in 1802,

We might hope to see the finances of the Union as clear and intelligible as a merchant's book, so that every member of Congress and every man of any mind in the Union should be able to comprehend them...I hope...that by our honest and judicious reformatations, we may be able...to bring things back to that simple and intelligible system on which they should have been organized at first.⁶

This goes to show that managing the funds of the country has always been a major concern, if not an intolerable frustration. But, it set the standard of financial management for which federal officials should strive. It is also the standard that is yet to be achieved; an intelligible system that produces information everyone can understand and trust.

For the last 200-plus years there have been several major landmark reforms which have shaped and evolved how government finances are handled. But, it is the initiatives of the last 30 years which have led to several reform measures throughout the federal government that have a large impact on how the Department currently conducts its business. The current initiative specific to the Department of Defense is the Financial Improvement and Audit Readiness Plan.

During the 1960's the pace of change in the federal government quickened with an explosion of new federal programs. Integrated financial management systems failed to keep up with those rapid changes happening within the federal government. Ad hoc tracking systems were developed so managers "in the trenches" could complete daily tasks. Focus shifted, especially

⁶ Jerry McCaffery and L.R. Jones, *Budgeting and Financial Management in the Federal Government* (Connecticut: Information Age Publishing, 2001), 337.

in the Department of Defense, on figuring out what to spend money on (i.e. budgeting and budget accounting) and less on how the money was spent (or more specifically, what was bought and the return on money spent).

By the early 1980's, this lack of attention to, and resources for financial management had reached a point of criticality. The Reagan Administration took over the White House and found, "thousands of antiquated, duplicative management systems that could not provide even elementary government-wide management information to the President or his key managers."⁷ The country was in a recession and the President's economic policies emphasized the need for increased deficit spending within the government. The convoluted and antiquated accounting systems, along with a lack of internal controls, left the government vulnerable to cases of fraud, waste, and abuse.

There were initiatives already underway by the executive and legislative branches to rein in control financial management within the government. An important step was the passage of the Inspector General Act of 1978. This required the establishment of the Office of Inspector General (IG) in federal departments and agencies. These offices conducted independent investigations and audits of government agencies, supervised the work of non-federal (contracted) auditors, and aided in the establishment of federal auditing standards. It was after passage of this act, Federal IG's were able to document many of the material weaknesses in financial internal controls within the departments and agencies.⁸

As the picture started to become clear about the state of financial management within the government, the President and Congress enacted the Federal Managers' Financial Integrity Act of 1982 (FMFIA). This act required federal agencies to make ongoing evaluations of accounting practices, internal controls, and note material weaknesses. These weaknesses were to be reported annually to the President and Congress by each agency. Reporting standards

⁷ Charles McAndrew, "Strengthening Controls for Better Government" Government Accountants Journal (Winter 1990) 30.

⁸ Ibid., 29.

were set by the Comptroller General of the Government Accounting Office (GAO). While this act mandated the reporting of weaknesses, it did not establish the framework for discrepancies to be fixed.

The FMFIA was one part of the President's plan called the 'Reform 88' agenda, started in 1982, which was a multidimensional program to improve management information problems. Aside from the FMFIA, other initiatives were handled internally to the Executive Branch through the Office of Management and Budget (OMB), working closely with the GAO. A push was made to modernize the accounting systems, strengthen internal controls, and provide more uniform financial information.

Despite the time, money, and manpower expended on these efforts, the results were lacking. Charles McAndrew, a Department of the Navy financial manager at the time, noted in 1990, "...financial management remains a pathetic disaster in most federal departments and agencies. While audit, IG, evaluation and FMFIA reports have found many material deficiencies, departments and agencies still fail to take corrective actions."⁹ Amidst this environment, charges of fraud, waste, and abuse in the federal government continued to mount, and public perception of the government's ability to manage its finances decreased.¹⁰

B. THE 1990'S AND CONGRESSIONAL LEGISLATION

By the end of the 1980s, financial management of government resources had become an issue which required an elevated level of attention at the Congressional level. With massive defense spending increases during the decade, large budget deficits, and numerous media and government reports of possible fraud and waste, the public and Congress demanded to know what was actually happening to tax dollars.

⁹ Charles McAndrew, "Strengthening Controls for Better Government" in *Government Accountants Journal* (Winter 1990) 40.

¹⁰ Glenn Hall, "Federal Mismanagement Could Cost Taxpayers Up to \$150 Billion, GAO Says" in *The Wall Street Journal*. (New York, NY: 30 November 1989) 1.

In 1990 Congress firmly established its oversight role through a series of laws intended to increase the transparency of government management and cause the internal reforms necessary to better manage the people's money. They found:

Current financial reporting practices of the Federal Government do not accurately disclose the current and probable future cost of operating and investment decisions, including the future need for cash or other resources, do not permit adequate comparison of actual costs among executive agencies, and do not provide the timely information required for efficient management of programs.¹¹

This showed an unprecedented concern by Congress over the state of financial management within the government. The stage was set for the legislation which drives the political and operational environment government managers currently work in.

1. The Chief Financial Officers Act of 1990

The first of these laws was the Chief Financial Officers Act of 1990 (CFO Act). This was the first act which made a requirement for a federal agency to actually report on its financial position using financial statements similar to those of the private sector. It also required federal agencies to establish positions within their organizations to deal exclusively with financial issues.

In broad terms, the CFO Act was passed to achieve three overarching objectives.

- Bring more effective general and financial management practices to the Federal Government;
- Provide for the improvement of accounting systems, financial systems, and internal controls;
- Require the production of financial statements for the use of the executive agencies and Congress for evaluation of performance.¹²

The Act established several mechanisms to achieve these goals. The first was establishment of the Office of Federal Financial Management inside of OMB. It was to be headed by a new Deputy Director of Management, appointed by the

¹¹ U.S. Public Law 101-576, 101st Congress, 2nd Session (23 January 1990), Title 1, Section 102.

¹² Ibid.

President. This office was intended to spearhead and coordinate the massive, but now dedicated, effort required to clean up the financial systems and practices across all of the federal agencies.

The next mechanism was the requirement that all federal departments and agencies establish Chief Financial Officers (CFO) within each organization. These offices were to coordinate financial management reforms within the individual departments and agencies.

The Act also established the formation of the CFO Council. It was to be headed by the Deputy Director for Management and include all of the individual government CFOs. This council was to meet periodically to coordinate efforts for improvement, including system modernization, data and reporting standards, internal controls, and legal requirements.¹³

The part of the Act which was to have the most profound impact on the government was the establishment of a pilot program which would require certain agencies of the government to produce audited financial statements. OMB was given the latitude to dictate the format and content of the statements. But, they were required to include:

- The overall financial position of the department / agency;
- The results of operations;
- Cash flows or changes in the financial position;
- Reconciliation to the budget reports.¹⁴

These statements were to be audited by the Inspector General of the agency or an external auditor designated by the IG. This pilot program affected the following agencies:

- Department of Agriculture
- Department of Labor
- Department of Veterans Affairs
- The General Services Administration
- The Social Security Administration

¹³ U.S. Public Law 101-576, 101st Congress, 2nd Session (23 January 1990), Title 3, Section 302.

¹⁴ Ibid., Section 303.

- Department of Housing and Urban Development
- Department of the Army
- Department of the Air Force
- The Internal Revenue Service
- The United States Customs Service

The pilot was to run until March, 1993, and OMB was to deliver a final report to Congress by 30 June, 1993.

The CFO Act was a landmark piece of legislation. It began the process of improving management within the government through reporting. The theory being that agencies would have to clean up their financial systems and practices in order to generate an auditable statement. It also had the backing of law.

2. The Government Performance and Results Act of 1993

The next piece of landmark legislation was the Government Performance and Results Act (GPRA) of 1993. This required government agencies to link their performance to the goals they achieved, or failed to achieve. It was to make officials shift their thinking from a process-based organization to a results-based one.

The Act required government agencies to develop long-range strategic plans which were to be submitted to OMB and the Congress starting at the beginning of FY98 and every three years thereafter. These strategic plans were to include:

- A comprehensive mission statement;
- Outcome related goals and objectives for each major function;
- A description of how the objectives were to be achieved;
- Identification of key external factors which could affect performance;
- Cover a period of five years from the fiscal year it was submitted.¹⁵

The Act also set in motion the requirement to submit annual performance plans and reports. These plans and reports were to show performance goals and objectives in measurable terms. This was to “improve congressional decision

¹⁵ U.S. Public Law 103-326, 103rd Congress, 1st Session (5 January 1993), Section 3.

making by providing more objective information on achieving statutory objectives, and on the relative effectiveness and efficiency of Federal programs and spending.”¹⁶ It provided a not-so-subtle hint for federal managers to start thinking about performance results or their programs might be subject to future cuts.

OMB was given great latitude in implementing the Act. It was directed to designate agencies of its choosing for three pilot projects. These pilots were for performance goals, managerial accountability and flexibility, and performance budgeting. Applicability of the performance reports was made mandatory government-wide in 1999. That has since led to the development of the President’s Management Agenda (PMA) Scorecard compiled by OMB to track the progress and performance of the federal agencies. The performance budgeting pilot ended in 2001 and has not been incorporated into the federal budgeting process due to results falling short of being able to convince Congress and OMB that a change would be worthwhile.¹⁷

3. The Government Management and Reform Act of 1994

In late 1994, Congress passed the Government Management and Reform Act (GMRA) of 1994. This law expanded the applicability of the CFO Act to the remaining government agencies not included in the 1990 pilot program. All 24 major federal agencies would now be required to submit annual audited financial statements. These statements were to be produced by March, 1997. Additionally, it required OMB to generate a consolidated financial statement of the entire federal government by March, 1998, which would be audited by the Comptroller General.¹⁸

4. The Federal Financial Management Improvement Act of 1996

By 1996 Congress felt the need to further strengthen and clarify its intentions with regards to financial reporting. Amongst Congress’ findings were:

- Accounting standards had not been uniformly implemented across the agencies;

¹⁶ U.S. Public Law 103-326, 103rd Congress, 1st Session (5 January 1993), Section 2.

¹⁷ Jerry McCaffery and L.R. Jones, *Budgeting and Financial Management for National Defense* (Connecticut: Information Age Publishing, 2004), 422.

¹⁸ U.S. Public Law 103-356, 103rd Congress, 2nd Session (25 January 1994), Title IV, Section 405.

- Accounting practices did not accurately report the full cost of programs or reflect the total liabilities of congressional actions;
- Possible waste and abuse undermines the credibility of the government and reduces the confidence of the American people in the government's ability to manage resources;
- Progress had been made on management reform, but further improvement was required.¹⁹

With this, Congress passed the Federal Financial Management Improvement Act (FFMIA) of 1996.

The FFMIA was intended to bolster the other legislation previously passed by mandating better use of accounting and reporting standards. In 1990 the Federal Accounting Standards Advisory Board (FASAB) was established to set the equivalent of Generally Accepted Accounting Principles (GAAP) for federal agencies. This was due to a need to differentiate between public and private sector accounting standards.

It also called for management systems to be able to support the disclosure of the full costs associated with federal programs. Better monitoring of budget execution was required by the linking of spending with activity results in reports.

FFMIA compliance required agencies to report on the status of their management systems and confirm they were meeting FASAB standards. If they were not in compliance, they were required to submit a timeline for compliance and the plan to fix discrepancies.²⁰ Furthermore, the act also required the Inspector Generals and the GAO to include agency FFMIA compliance in reports to Congress.²¹ Reports were to be submitted by 1997. In 1999, only 3 of the 24 CFO Act agencies had financial systems in compliance.²² For 2005, the number of agencies in compliance had only climbed to 6 out of 24.²³ See Figure 2-1.

¹⁹ U.S. Public Law 104-208, 104th Congress, (30 September 1996), Section 802.

²⁰ U.S. Public Law 104-208, 104th Congress, (30 September 1996), Section 803.

²¹ U.S. Public Law 104-208, 104th Congress, (30 September 1996), Section 804.

²² Jerry McCaffery and L.R. Jones, *Budgeting and Financial Management in the Federal Government* (Connecticut: Information Age Publishing, 2001), 353.

²³ Government Accountability Office, "Improvements Under Way But Serious Financial Systems Problems Persist". GAO-06-970. (Washington D.C.: 26 September 2006).

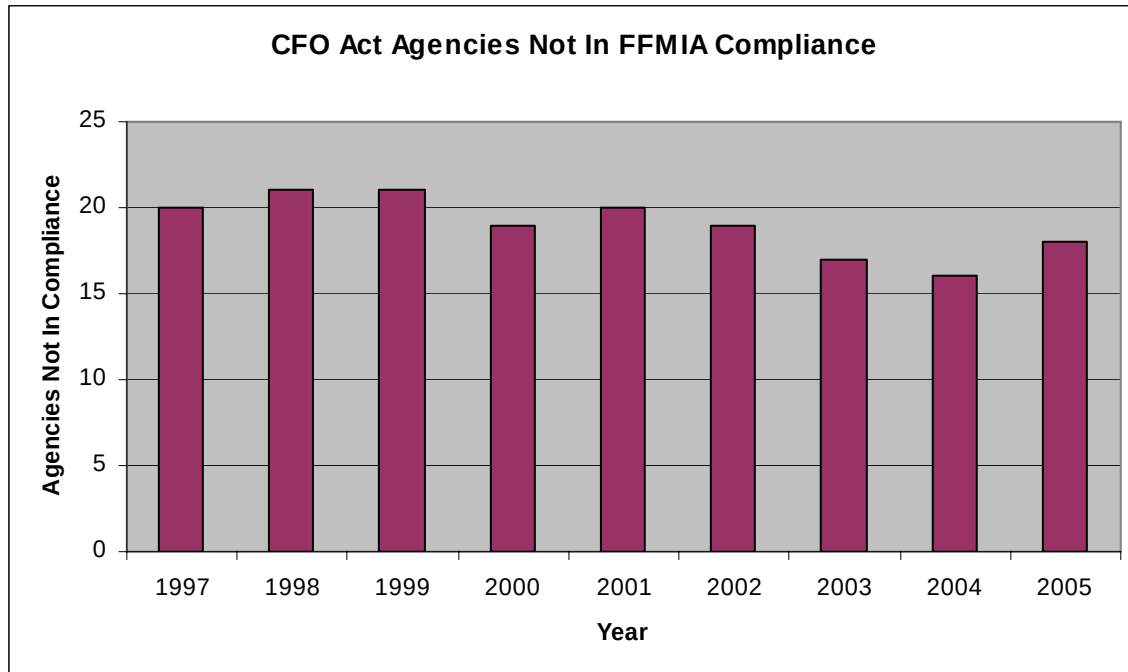


Figure 2-1. CFO Act Agencies Not in FFMIA Compliance

C. DEPARTMENT OF DEFENSE RESPONSE

Until 1991, all of the individual services and agencies within the DoD had their own accounting and pay services. In 1991, the Defense Finance and Accounting Service (DFAS) was created. This agency was to consolidate many of the individual pay and accounting systems into one service. It reduced the number of accounting offices from 324 to 26, and personnel from 27,000 to just over 15,000. It is important to note that DFAS was not an outcome of the CFO Act. Prior to passage of the CFO Act, the DoD recognized that performance gains and cost savings could be realized from standardizing certain financial management functions and pulling them out of the services into an independent agency.

Regarding the requirements of the GPRA, the DoD may have had an easier time with compliance than other federal agencies. The Planning, Programming, and Budgeting System (PPBS)²⁴ that DoD had used for decades to build long-range plans and budgets provided a good framework for incorporating elements of the GPRA and performance reports. The annual

²⁴ "Execution" has since been added, making it the PPBE System.

performance report was incorporated into the programming phase of PPBS. The vehicle used for submitting DoD's strategic plan with financial performance measures was President Clinton's Bottom-Up Review, first published in 1993. This evolved into the Quadrennial Defense Review (QDR) in 1997. It is an overarching document that includes many other elements besides financial. The Department was able to get permission from Congress to allow using this document as the strategic plan for GPRA compliance to be submitted every four years vice the three-year requirement of the Act. The services were then required to link their own strategic plans to the QDR.²⁵

1. The Friedman Report

Other initiatives within the Department continued to try improving systems and processes. However, results were slow in coming and disappointing in effect. Under the George W. Bush Administration, the Secretary of Defense commissioned an independent study to evaluate the status of financial management in the Department and recommend a direction for future action. This study was called "Transforming Department of Defense Financial Management: A Strategy For Change," published in April, 2001. This is also known as the 'Friedman Report', named for the chairman of the study committee.

The study found 10 major situations and problems with the financial environment that needed to be addressed. They were:

- An inability to consistently provide reliable financial and managerial data for effective decision making;
- A lack of an overarching approach to financial management with disparate systems (accounting, financial, and feeder) hampered by lack of integration and standardization;
- Overly complex data requirements driven by appropriation funding rules, elaborate policies and procedures, and outdated guidelines for excessively detailed tracking of expenditures;
- Too many convoluted business processes which fail to streamline excessive process steps;
- Changing federal financial management standards created a moving target for CFO Act compliance;

²⁵ Alice C. Maroni, "Department of Defense Implementation of the Government Performance and Results Act," *The Armed Force Comptroller* (Winter 1998) 12-14.

- Difficulty in obtaining financially based, outcome oriented management metrics which link financial management to DoD goals;
- Inability to produce CFO Act compliant annual financial statements.
- Disproportionate budget dollars appear to support non-value added activities;
- Cultural bias toward the status quo, driven by disincentives for change, and short time frames for political appointees;
- A requirement for an infusion of personnel with technical and financial skill sets necessary to achieve integrated financial management systems.²⁶

While the study acknowledged that there were “positive projects” being undertaken, they were narrowly focused, lacked commitment from senior leaders, and were not part of a comprehensive plan.²⁷ In essence, during the 10 years since passage of the CFO Act, the DoD had not made sufficient improvements to its financial management that achieved the positive results intended by the congressional legislation.

The paper called for a “twin-track” approach to setting a new direction for the Department. Track 1 was to make the structural changes necessary to integrate systems, establish a centralized process, achieve clean opinions on audits, and ultimately provide relevant and reliable financial information. These changes would require an extended timeframe to complete and would need centralized oversight for standardization and integration.²⁸ It was recommended that implementation be directed from the USD(C) through two offices under his/her control. The first would be the Financial & Management Information Integration Office, which would coordinate systems and standards development and be geared for Track 1 objectives.

Track 2 was to provide “close-in” successes. It was intended to target projects that could provide high-value benefits inside and across the services to

²⁶ DoD Report, “Transforming Department of Defense Financial Management: A Strategy for Change” (13 April 2001) 4-9.

²⁷ Ibid., 2.

²⁸ DoD Report, “Transforming Department of Defense Financial Management: A Strategy for Change” (13 April 2001) 15.

demonstrate value of the approach.²⁹ “Dashboard Metrics” were to be formulated based on the Secretary of Defense’s Critical Success Factors. This track would be managed under the USD(C)’s second office, the Management Initiatives Office, which would work with the DoD components with metric and project development.³⁰

The report states that there would be no quick fixes to the problems. This would be a prolonged process requiring cultural as well as systems changes. It also stressed that Congress and OMB would have to be part of the solution. Finally, it would require the active participation of the Secretary of Defense and his senior managers to make this process work.³¹

2. The Business Management Modernization Program (BMMP)

With the Friedman Report in hand, Secretary of Defense Donald Rumsfeld initiated the Financial Management Modernization Program (FMMP). It was later renamed the Business Management Modernization Program (BMMP). This program was to begin fixing many of the long standing problems associated DoD business processes, modernize financial systems, and do so in an integrated framework that reduced redundancy and promoted standardization.

The BMMP had two major goals and six objectives. They were:

1. Provide timely, accurate, reliable information for business management;
 - Achieve an unqualified audit opinion on the FY2007 financial statements
 - Achieve total visibility and accurate valuation of assets including Operating Materials and Supplies (OM&S); inventory; and Property, Plant, and Equipment (PP&E) by 2007
 - Achieve total personnel visibility to include: active military, civilian employees, military retirees, and other U.S. federal personnel and contractors in a theater of operations by 2007
 - Provide DoD decision makers timely access to business information

²⁹ DoD Report, “Transforming Department of Defense Financial Management: A Strategy for Change” (13 April 2001) 15.

³⁰ Ibid., 16, 17.

³¹ Ibid., 18.

2. Enable improved business operations;
 - Adopt a Business Enterprise Architecture (BEA) for acquiring, managing, and providing material and personnel in support of operational forces
 - Systematically enable efficiency and productivity improvements to DoD business operators.³²

This program also created the position of Deputy Undersecretary of Defense (Financial Management) under the USD(C).

By April 2003, the initial version of the BEA was released. This was intended to create a common framework for consolidation and improvement of financial systems. As part of the process to formulate the BEA, the BMMP office took an inventory of financial and business systems in the Department. They uncovered 2,274 such systems. As part of the BEA, any new system or changes to current systems required the approval of the Under Secretary of Defense (Comptroller).

Proponents of the program argued that BMMP was getting DoD to move in the right direction concerning business processes. However, others were very critical of the results being produced. Despite the supposed controls with regard to financial systems, the number grew from 2,274 in 2004, to over 4,150 by the following year.³³ This increase was likely due to becoming more aware of what systems were in place. Business modernization had been an area on the GAO's High Risk list since 1995. Despite almost three years of existence and the introduction of the BEA, the BMMP had not improved that status.³⁴ Additionally, it became very clear that the aggressive objective of achieving Department-wide audited financial statements would not be achievable until well after the 2007 goal.

3. The Business Transformation Agency

In October 2005, Congress was notified that the BMMP was to be reorganized into the Business Transformation Agency (BTA). It was felt that there

³² Robert Jennings, "BMMP – A Progress Report," *The Armed Forces Comptroller* (Winter 2004) 10.

³³ Frank Tiboni, "Getting Back On Track," *Federal Computer Week* (May 9, 2005) 20.

³⁴ Government Accountability Office, *High Risk Series: An Update*, GAO-05-207 (January 2005)

were too many individual service and other DoD agency transformation initiatives going on that they needed to be organized under one tent. The BTA was recognized as an official organization in February 2006.³⁵ The mission statement for the BTA was: "Guide the transformation of business operations throughout the Department of Defense and deliver enterprise-level capabilities that align to our warfighter needs."³⁶ Transformation efforts were broken down into six Business Enterprise Priorities (BEPs). They are:

- Personnel visibility;
- Acquisition visibility;
- Material visibility;
- Real property accountability;
- Common supplier engagement;
- Financial visibility.³⁷

The BTA is still in existence and is the organization that is overseeing all of the transformation activities in the Department.

4. A Need for A Plan

With the formation of the BTA it was recognized that there needed to be a comprehensive and realistic plan to achieve the financial aspects of the business transformation efforts. What had been tried in the past had not worked and current programs were not achieving results, and those failures were receiving an increasing amount of public scrutiny. This was the environment that created the requirement to develop the Financial Improvement and Audit Readiness Plan.

³⁵ Henry S. Kenyon, "Business Transformation Agency Hits the Ground Running" Signal (September 2006) 64.

³⁶ Elizabeth A. McGrath, "Accelerating DoD Business Transformation: New Initiatives Driving Long-Term Improvements in Processes and Technology" *The Journal of Government Financial Management* (Summer 2006) 42.

³⁷ *Ibid.*, 43.

III. DOD'S FIAR PLAN

A. THE PLAN FORMATION

The following section is a description of the formation of the Financial Improvement and Audit Readiness (FIAR) Plan, its organization, goals, mechanics, and progress to date.

1. Rationale

As stated in the previous chapter, with the evolution of business transformation in the Department, it became apparent that the problems with business systems and processes were much more extensive and complicated than first thought. In January, 2005, DoD's business transformation became a new area added to the GAO's High-Risk list to Congress. The Comptroller General noted:

Although the Secretary of Defense and senior leaders have shown a commitment to business transformation, as evidenced by individual key initiatives related to acquisition reform, business modernization, and financial management, among others, little tangible evidence of actual improvement has been seen in DoD's business operations to date. ... (the) DoD has not taken the steps it needs to take to achieve and sustain business reform on a broad, strategic, department-wide and integrated basis.³⁸

With the formation of the BTA, all transformation efforts, not just financial, would be standardized under one roof.

Under the BMMP, which became the BTA, an Enterprise Transition Plan (ETP) was developed to cover all *department-wide* initiatives. However, individual component transition plans, some of which had been initiated in the late 1990s, were not discounted. Taken together, this became the standard Business Enterprise Architecture (BEA) for the DoD. The BEA would set the standards and requirements for all future business systems in the Department. Planning an execution would be accomplished through a concept called Tiered

³⁸ Government Accountability Office, *High Risk Series: An Update*, GAO-05-207 (January 2005) 21.

Accountability. This is an approach which divides planning and management of systems and initiatives between the enterprise, component, and program levels.³⁹

Included in the BEA are enterprise-wide standards which cover the priority areas. There are several systems and standards covered under the BEA. One of these is the Standard Financial Information Structure (SFIS) which supports the Financial Visibility BEP. By ensuring all financial systems are SFIS compliant, regardless of the origin of the system, the information being fed through the DoD will be standard and transferable. That includes interoperability between the other priority areas. The information construct is designed to link six information components;

- Appropriation account information
- Budget program information
- Organizational information
- Transactional information
- Trading partner information
- Cost accounting information⁴⁰

SFIS is being incorporated into all new financial system projects. Eventually it will be required for all operating financial systems.

With regard to the financial requirements for the BEA, a single integrated plan needed to be devised to coordinate the transformation efforts of the various components and agencies. The Financial Improvement and Audit Readiness (FIAR) Plan was first released in December 2005. Since that initial release, there were updates to the Plan released in June 2006, and the latest in September 2006.

2. Organization

It is important to note, that the FIAR Plan is not just a written document, but it is part of an organization within the Department. The FIAR Directorate

³⁹ Business Transformation Agency, *BMA – Federation Strategy and Roadmap*. (26 September 2006) 34.

⁴⁰ Christine Wenrich, "We're Talking SFIS: Introducing the Common Business Language of DoD" in *The Armed Forces Comptroller*. (Spring 2005) 20.

resides with the Under Secretary of Defense (Comptroller) (USD(C)), and reports through the Deputy Chief Financial Officer (DCFO). The Directorate is responsible for managing the FIAR program, maintaining the web-based FIAR Planning Tool, organizing cross-component financial improvement workshops, managing the audit readiness process, and publishing updates to the FIAR Plan twice a year.⁴¹ Figure 3-1 below shows the organization of the USD(C) office and the relation of the FIAR Directorate.

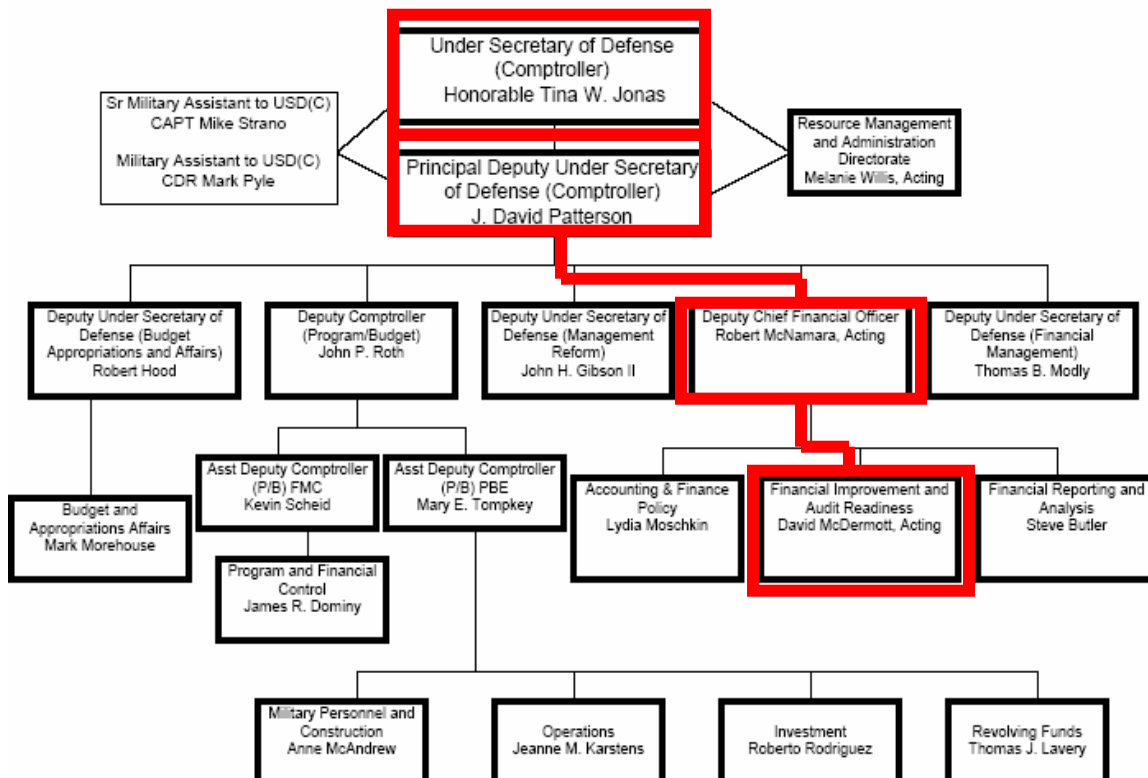


Figure 3-1. USD (Comptroller) Organization
Source: USD(C) Website: www.dod.mil/comptroller/chartindex.html

The FIAR directorate is *not* part of the BTA. Note that it does not report through the BTA, but through USD(C). It provides the mechanism by which the USD(C) can ensure corrective actions for financial management initiatives are aligned with the standards set by the BTA (such as the BEA and SFIS),

⁴¹ Defense Financial Improvement and Audit Readiness Plan (June 2006 Update) 2.

documented, verified, and tracked. In other words, it is an *enabler* for the other components and agencies as they do the work of completing their requirements. The relationship is shown below in Figure 3-2.

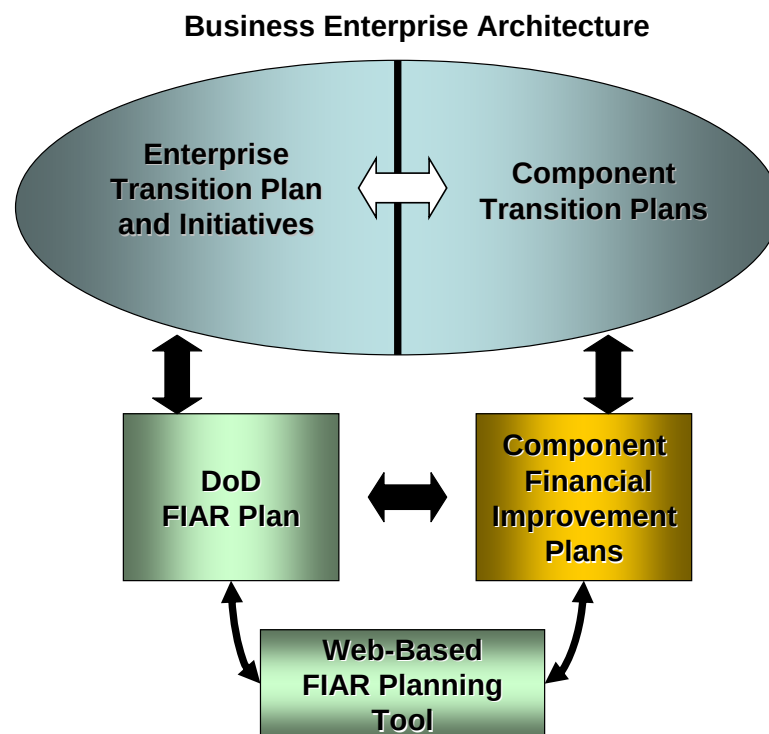


Figure 3-2. FIAR Plan Relationships With BEA and Components
Source: Generated From BTA Website: www.dod.mil/dbt/tools_fiar.html

The FIAR Committee sets the priorities for the planning approach. The Committee is chaired by the DCFO, and has representation at the executive level from the Office of the USD(C), the Military Departments, the Defense Logistics Agency (DLA), the Defense Finance and Accounting Service (DFAS), and the BTA. The DoD Inspector General acts as an advisor to the Committee. The Committee meets once a month, or as needed.⁴² The FIAR Committee established six principles by which to guide the planning process:

⁴² Defense Financial Improvement and Audit Readiness Plan (December 2005) Appendix Q.

- Institute one DoD financial improvement plan with tiered Component plans and accountability;
- Employ a collaborative management process;
- Use a prioritized, incremental approach;
- Integrate transformation programs across the components;
- Optimize performance through standardized processes, controls, and systems;
- Leverage the lessons learned from component approaches, challenges, and successes.⁴³

Additionally, the Committee is chartered to advise the USD(C) on matters related to financial improvement, and ensure improvements are aligned with broader context of business transformation.⁴⁴

With these principles established, several workshops were organized where the services and agencies met to hammer out the specifics of what was to become the FIAR Plan. Because many of the participants already had individual Financial Improvement Plans (FIPs) from earlier attempts at reforms, this knowledge base could be leveraged. Problems, limitations, and weaknesses with process and controls were brought to the attention of the group. Cross-component relationships were identified, and solutions were made to be compliant with the BEA. Finally, these groups were able to analyze the situation in total, and recommend the setting of high-level milestones for resolving deficiencies. These milestones are known as Key Milestone Plans (KMPs) and are grouped into Focus Areas.⁴⁵ KMPs will be discussed further in a following section.

3. FIAR Plan Goals

The stated improvement goals of the Plan are written to conform to the capabilities stated under the “Financial Visibility” category of the ETP. Initiatives that are enacted should improve information accuracy and timeliness in these areas. These capabilities are:

⁴³ Defense Financial Improvement and Audit Readiness Plan (December 2005) 14.

⁴⁴ Ibid., Appendix Q.

⁴⁵ Ibid., 14.

- *Forecast, Plan, Program, and Budget.* It is the ability to develop, review, evaluate, and support financial forecasts, plans, programs, and budgets and integrate them with appropriate performance indicators to achieve effective business operations and programs goals.
- *Manage Financial Assets and Liabilities.* The ability to identify, classify, value, and manage fiscal assets, to include accounts receivable; and liabilities, to include accounts payable from acquisition inception to disposal or liquidation.
- *Funds Allocation, Collection, Disbursement, and Control.* The ability to control and distribute funds based on appropriation and authorization laws, and the ability to monitor such funds against available balance.
- *Manage General Ledger.* The ability to record propriety and budgetary general ledger (USSGL) transactions in accordance with accounting standards of the FASAB, GAAP, and other regulatory requirements.
- *Managerial Accounting.* The ability to accumulate, classify, measure, analyze interpret, and report cost and other financial information useful to internal and external decision makers. It also enables the review of the execution of an organization's program or project resources to ensure they are effectively being used to meet objectives
- *Financial Reporting.* The ability to provide relevant financial visibility and real-time information dashboards for DoD decision makers; the ability to summarize financial information for the purposes of producing mandatory reports in compliance with regulatory requirements; and the ability to develop discretionary reports in support of other requirements.⁴⁶

Ultimately, the goal of the Plan is to be able to obtain an audit opinion on the entire Department. Current projections have that happening around 2017. However, the Plan also states that such predictions will change over time. Looking at a shorter timeframe, the Department expects to achieve "clean" opinions for 71% of its assets, and 80% of its liabilities by 2010.⁴⁷

⁴⁶ Defense Financial Improvement and Audit Readiness Plan (December 2005) 15.

⁴⁷ Ibid., 8.

B. THE PROCESS

1. AUDIT PROCESS

Congress, through the National Defense Authorization Act for FY2002, ordered the DoD to minimize spending money on audits until improvements were in place and verified.⁴⁸ The rationale was to not waste money performing audits on line items or organizations that were known to be deficient and would receive a disclaimed opinion anyway. Through the FIAR Plan, organizations preparing for audits are required to follow a five-step process. The five steps are:

1. *Discovery and Correction.* Command management reviews its policies, processes, controls, and systems to identify weaknesses that impede accuracy, reliability, or timeliness of financial information. It then identifies and implements the appropriate corrective actions.
2. *Validation.* Commands validate that corrective actions successfully resolve weaknesses. The scope of the validation is at the discretion of the management.
3. *Assertion.* Commands assert to the DoD Inspector General the reliability of the financial information. This is done through an assertion package submitted to the DoD Financial Improvement Executive Steering Committee via the command's component or agency. The Committee reviews the package to ensure the assertion can pass the scrutiny of an independent audit. Once approved, the component makes funding available for the DoD IG for the assessment.
4. *Assessment.* The DoD IG performs a limited review of controls and procedures to determine if the financial information is credible for a full financial audit. This may be done by the IG, or contracted to an Independent Public Accountant.
5. *Audit.* The DoD IG or contracted Independent Public Accountant performs a full financial audit.⁴⁹

The components and agencies have identified many of the material weaknesses that prevent them from receiving a favorable audit through their FIPs. As the agencies fully implement corrective actions for line items, they begin

⁴⁸ U.S. Public Law 107-107, 107th Congress, (28 December, 2001), Section 1008.

⁴⁹ Defense Financial Improvement and Audit Readiness Plan. (December 2005) 11.

the systematic process that will ultimately lead to a full audit of that item. Timelines for the line items have been established for each component in each Focus Area.

The DoD's Balance Sheet is used to group corrective activities into focus areas. For example, Real Property is an asset item on the balance sheet. The corrective actions taken by each of the components that affect the real property statement item are tracked collectively under the Real Property Focus Area by the FIAR Directorate. The plans which establish the milestones to complete individual line items are referred to as Key Milestone Plans (KMPs). Figure 3-3 below is an example from the FIAR Plan of part of a KMP for the Navy under the Real Property Focus Area.⁵⁰ Milestones track the progress of the five-step process from discovery through audit. As of June, 2006, the FIAR Plan was tracking 954 key milestones.⁵¹

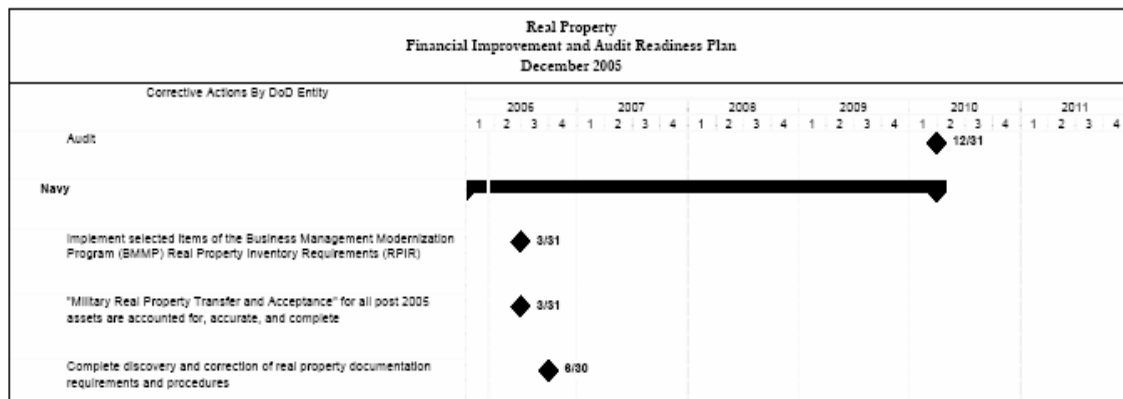


Figure 3-3. FIAR Plan KMP Example
Source: December 2005 FIAR Plan

Because the components were in various stages of progress with their respective FIPs prior to the FIAR Plan, the timelines for completion of focus area line items vary greatly. For example, the Fund Balance With Treasury focus area,

⁵⁰ Defense Financial Improvement and Audit Readiness Plan. (December 2005) Appendix B-3.

⁵¹ Defense Financial Improvement and Audit Readiness Plan June 2006 Update. (June 2006) i.

the Air Force should have completed its audit in FY 2008. The Army's Working Capital Fund, Navy, and DLA are not forecasted to be audited in that area until FY 2011.⁵²

2. Material Weaknesses

The DoD IG has identified 11 material internal control weaknesses in the Department which may adversely affect the accuracy and reliability of financial information. These weaknesses were identified following previous audits. The FIAR Plan is intended to coordinate and ensure that Components discover the causes of these weaknesses within their organizations, and apply corrective measures which follow the standardized frameworks established within the ETP. The 11 material weaknesses are:

- 1. Financial Management Systems:** The DoD cannot collect and report financial and performance information that is accurate, reliable, and timely due to system-wide gaps, and financial systems and business processes problems.
- 2. Intragovernmental Eliminations:** The DoD cannot reconcile transactions involving the exchange of goods and services within the DoD *and* with other federal agencies.
- 3. Accounting Entries:** The DoD continues to enter unsupported accounting entries. These are adjustments made to accounting records to balance ledgers when they do not add up.
- 4. Fund Balance With Treasury:** The DoD cannot reconcile its records with the U.S. Treasury.
- 5. Environmental Liabilities:** The DoD lacks the infrastructure to identify, estimate, and report environmental liabilities.
- 6. General Property, Plant, and Equipment (GPP&E):** The cost and depreciation of GPP&E is not reliably reported. This is due to changes in reporting requirements, a lack of supporting documentation for GPP&E purchased several years ago, and the use of legacy systems which are not integrated and incapable capturing costs or calculating depreciation.
- 7. Government Property and Material in the Possession of Contractors:** The DoD does not have an accurate inventory and related costs for property in the possession of contractors. This is similar to the GPP&E weakness.

⁵² Defense Financial Improvement and Audit Readiness Plan. (December 2005) 24.

8. **Inventory:** Existing inventory valuation of most activities is not reported in accordance with Generally Accepted Accounting Principles.
 9. **Operating Materials and Supplies:** DoD systems are designed to expense materials when purchased rather than when consumed.
 10. **Statement of Net Cost:** The Statement of Net Cost is not presented by programs that align with major goals and outputs in the DoD's strategic and performance plan, as required by the Government Performance and Results Act. Revenues and expenses are reported by appropriation categories due to the legacy systems.
 11. **Statement of Financing:** The DoD cannot reconcile budgetary obligations to net cost without making unsupported adjustments.⁵³
3. **Focus Areas**

In December 2005, the FIAR Plan selected four areas in which to focus efforts and correct reported weaknesses. These were Military Equipment, Real Property, Medicare-Eligible Retiree Health Care Fund, and Environmental Liabilities. The reasons to focus on these areas first was 1) these areas represent a large portion of the DoD's assets and liabilities 2) corrections could have an immediate impact 3) limited resources prevent tackling all areas at once. By setting these areas as priorities throughout the Department, the Components could align their FIPs to maximize resources and efforts in initiatives that would benefit the Department as a whole.

The September 2006, version of the FIAR Plan added three more Focus Areas to the list. These areas were Inventory and Operating Materials and Supplies, Accounts Payable, and Accounts Receivable.⁵⁴ These additions by the FIAR Committee were in keeping with the principle of an incremental approach to improvements.

In addition to the new Focus Areas, the Committee established four new Priority Areas. They were Fund Balance with Treasury, U.S. Marine Corps, Military Pay, and Military Obligations. These areas were chosen as priorities because they either were projected to achieve accelerated results, or had a high

⁵³ Defense Financial Improvement and Audit Readiness Plan (December 2005) 22-27.

⁵⁴ Defense Financial Improvement and Audit Readiness Plan (September 2006) 12.

impact on the Balance Sheet or DoD-wide financial improvement efforts.⁵⁵ What the relationship is between Focus Areas and Priority Areas was not mentioned in the Plan.

4. Audit Strategy

An unqualified or “clean” opinion on the DoD’s consolidated financial statements should provide validation that the underlying financial infrastructure is providing accurate, reliable, and timely information to users and decision makers. The Department is several years away from being able to pass that test. The FIAR Plan sets the process and timelines in a systematic approach to achieve an unqualified opinion by 2017.

There are three stated objectives of the DoD audit strategy. They are:

- Sustainable financial improvement for an ascending unqualified audit opinion of DoD consolidated financial statements;
- Sufficient audit readiness for receiving an unqualified audit opinion for each of the Military Departments and select Defense Agencies;
- Assurance that the financial recording and reporting by Defense Field Activities that are not required to prepare auditable financial statements are not constrained by any material weakness that would impair the timely, fair, and accurate presentation on financial statements.⁵⁶

DoD agencies are divided into 4 Tiers which represent the level of requirements of an agency to produce financial statements and conduct audits.

- *Tier 1:* Includes those DoD Components that are required to undertake an annual audit engagement. They Include:
 - Army General Fund and Working Capital Fund;
 - Navy General Fund and Working Capital Fund;
 - Air Force General Fund and Working Capital Fund;
 - Military Retirement Fund;
 - U.S. Army Corps of Engineers;
 - Medicare-Eligible Retiree Health Care Fund.⁵⁷

⁵⁵ Defense Financial Improvement and Audit Readiness Plan (September 2006) 28.

⁵⁶ Defense Financial Improvement and Audit Readiness Plan (September 2006) Appendix F-1.

⁵⁷ Ibid., Appendix F-2.

- *Tier 2:* Includes the Defense Intelligences Agencies that are required to produce financial statements and are subject to annual audit.
- *Tier 3:* Includes those agencies that are required by the DoD to produce full financial statements and are subject to annual independent audits. They include:
 - Chemical Biological Research Program;
 - Defense Advance Research Projects Agency;
 - Defense Commissary Agency;
 - Defense Contract Audit Agency;
 - Defense Finance and Accounting Service
 - Defense Information Systems Agency
 - Defense Logistics Agency
 - Defense Security Service
 - Defense Threat Reduction Agency
 - Missile Defense Agency
 - Special Operations Command
 - Service Medical Activity
 - TRICARE Medical Activity
 - U. S. Marine Corps
- *Tier 4:* Includes those Defense Field Activities that are not required to prepare stand-alone financial statements. Their financial information is included in the DoD consolidate financial statements.⁵⁸

These Tiers comprise the audit environment that the FIAR Plan must manage. It is using an incremental approach by emphasizing specific line items first. Emphasis will, as Components and Agencies become prepared, shift to stand-alone financial statements for the organizations, and then eventually to the consolidated statements for the Department as a whole. The variables

⁵⁸ Defense Financial Improvement and Audit Readiness Plan (September 2006) Appendix F-3.

associated with planning the auditing timeline are numerous and complicated. Details of the next transition from a line item focus to a statement focus require further coordination with the Components and the DoD IG.⁵⁹

5. FIAR Planning Tool

The FIAR Planning Tool (FIAR-PT) is a web-based resource to manage many of the FIAR Plan initiatives. It is used as a centralized source for FIAR-related documents, as well as Business Transformation documents and Component Financial Improvement Plans. This tool aids in cross communication with managers, leaders, and other stakeholders. KMPs are updated and tracked using the FIAR-PT. Information is available cross-component, allowing components the opportunity to view plans and lessons learned from other teams.⁶⁰

C. PROGRESS

Some measurable progress was achieved prior to the release of the FIAR Plan Dec 2005. Five of the DoD Components had achieved unqualified opinions on audits. They were:

- Defense Commissary Agency
- Defense Contract Audit Agency
- Defense Finance and Accounting Service
- Defense Threat Reduction Agency
- Military Retirement Fund

The Military Retirement Fund alone represents 48% of the Department's liabilities. One other agency, the Medicare-Eligible Retiree Health Care Fund received a qualified opinion on its audit.⁶¹

The FIAR Plan includes 5-Year projections estimating when focus areas will receive unqualified or "clean" opinions on audits. In the Dec 2005 Plan, it was predicted that clean opinions could be made on 42% of assets and 48% of liabilities in FY2006. Further, by FY2010 71% of assets and 80% liabilities could

⁵⁹ Defense Financial Improvement and Audit Readiness Plan (September 2006) Appendix F-6.

⁶⁰ Ibid., Appendix E-1.

⁶¹ Defense Financial Improvement and Audit Readiness Plan (December 2005) 7.

be verified as clean.⁶² With the release of the Sep 2006 Plan, the FY2006 prediction was changed to 18% of assets and 48% of liabilities would be clean. The FY2011 forecast shows 72% of assets and 79% of liabilities receiving clean opinions.⁶³ No reason was provided for the changes in the forecasts. These changes are represented in Figures 3-4 and 3-5 below.

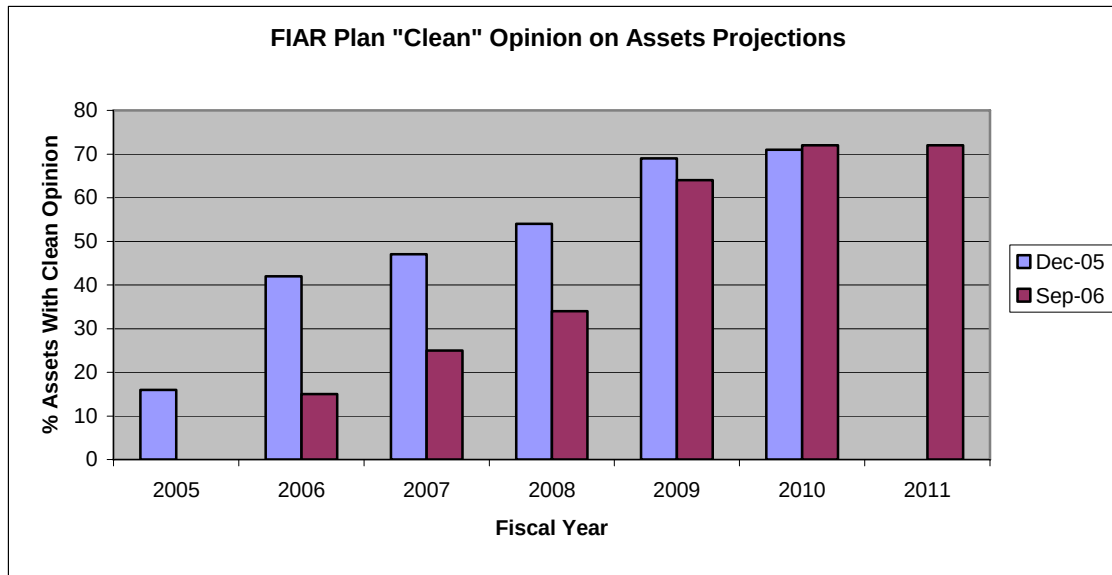


Figure 3-4. FIAR Projections for Assets
Source: Generated from December 2005 and September 2006 FIAR Plans

⁶² Defense Financial Improvement and Audit Readiness Plan (December 2005), 8, 9.

⁶³ Defense Financial Improvement and Audit Readiness Plan (September 2006) 1-4.

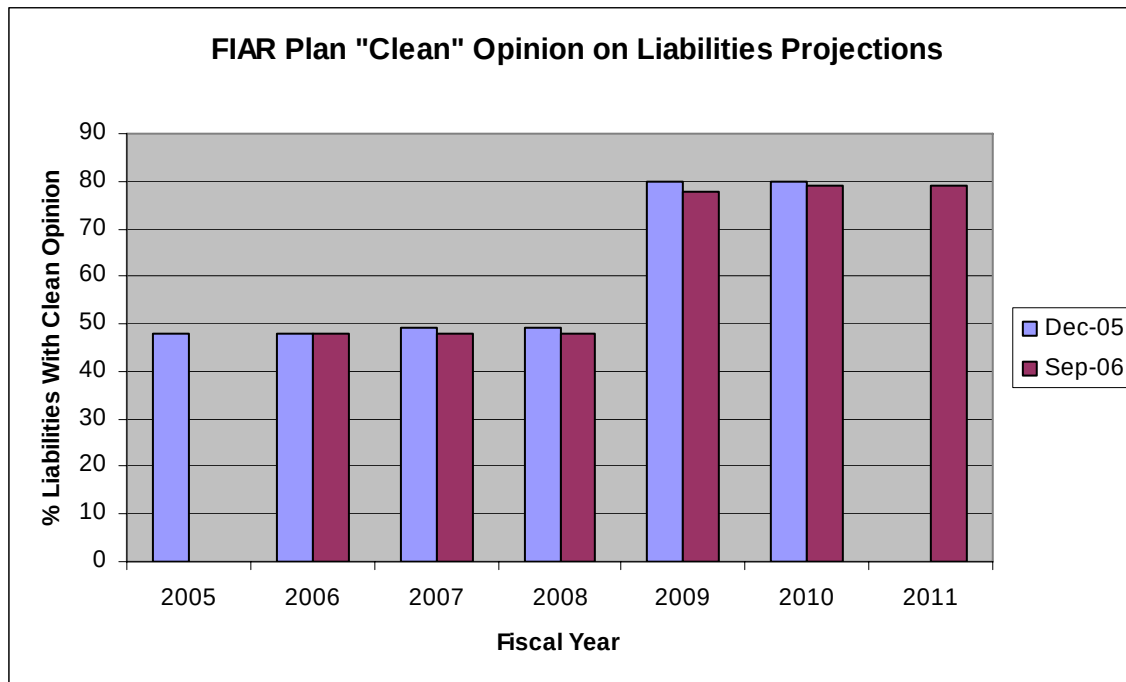


Figure 3-5. Projections for Liabilities
Source: Generated from December 2005 and September 2006 FIAR Plans

Components are being tracked on the timely completion of KMP line items. In FY2006, the Components completed approximately 81% of milestones. The significance of uncompleted milestones was not published.⁶⁴

Other significant accomplishments were achieved between January and September 2006. Some of these major items are:

- Army Corps of Engineers: FY2006 financials statements were being audited.
- Air Force:
 - Ready for audit of Fund Balance With Treasury
 - Ready for audit of Cash and Other Monetary Assets
- Defense Logistics Agency: Ready for audit of Contingent Legal Liabilities.
- Office Undersecretary of Defense (Acquisition, Technology, and Logistics) (OUSD(AT&L)): Issued revised policy standardizing core real property inventory data to improve financial reporting.

⁶⁴ Defense Financial Improvement and Audit Readiness Plan (September 2006) 4.

- Expanded the FIAR Planning Tool to include project plans for 108 Enterprise and Component transformation initiatives and system solutions under the BTA.
- Revised the capitalization threshold for Real Property to capture 99% of the expenditures for real property.
- Revised reporting regulations to more accurately report values on the Balance Sheet.⁶⁵

D. CONCLUSION

Bringing together all of the efforts geared for financial management reform is an enormous and complicated undertaking. The FIAR Plan is the DoD's program to do just that. The Plan is dependent on the work the individual components have done previously with their respective FIPs. The FIPs have now become the execution arms of the FIAR Plan. By leveraging the work previously completed by the components, the Plan was able to generate and track some measurable accomplishments over the first nine months of its existence. A detailed analysis of the individual component plans was beyond the scope of this study.

The creation of the FIAR Plan appears to be in keeping with the Friedman Report's vision of the Management Initiative Office. Through the FIAR Plan and the FIAR Directorate, the USD(C) is working closely with the components to focus efforts to gain immediate successes, promote programs that support long-term goals, and ensure accountability through periodic reporting.

These initial successes will help to establish the FIAR Plan as a viable strategy. However, those successes will have to be translated into sustained value creation in order to ensure the required changes happen and intended benefits are realized. That is the subject of the following chapters.

⁶⁵ Defense Financial Improvement and Audit Readiness Plan (September 2006), 5, 6.

IV. FIAR PLAN VALUE CREATION

The following chapter seeks to address the first major question; does the FIAR Plan create value, in the sense that it helps to meet desires and expectations of stakeholders concerned? This is accomplished through application of the FIAR Plan to a framework, and then examining the value elements of the stakeholders from the resulting points of view.

A. VALUE

The word 'value' is defined as "the quality (positive or negative) that renders something desirable or valuable."⁶⁶ It is an ideal that is accepted by some individual or group. Value is by definition very subjective. It is a conceptual measure which has different meanings to various groups or individuals. Thus, value can be a very difficult concept grasp and quantify, and even more difficult to achieve. But, it is important for a discussion on whether a program is worth the investment. Value, in a holistic sense, accounts for benefits and costs, whether they are tangible or not.

With regards to the private sector, value can be relatively easy to measure. Those activities which increase the bottom line (profits), increase company growth, and improve investor (shareholder) confidence would be considered valuable. It is relatively easy to attach a tangible measure to value, a dollar figure, for a private enterprise. Performance and progress are easier to track with these tangible measures. Accountability is also easy to assign. The stakeholders in a private company are fairly limited. They consist of customers, suppliers, employees, creditors, shareholders and a select number of special interest groups. Because of this limited number, it is easier for stakeholders to come into a general agreement as to what can be considered valuable for the enterprise.

The same cannot be said for a public organization. The issue of what is valuable becomes more blurred. Generally, public organizations do not produce products and services that are sold. A market system does not exist to determine

⁶⁶ www.dictionary.com. Accessed on 15 September 2006.

the worth of those services. Therefore, it is much harder to assign tangible measures to value creating activities. The number of stakeholders is much broader than that of a private organization. With regard to federal agencies, every citizen has a stake in the organization. It is much harder to generate a consensus of what constitutes value. The subjectivity of value complicates the task of creating the right value for stakeholders. Furthermore, the monetary measures used in private industry do not necessarily translate directly to the public side. However, it is still the job of managers in the public sector to use the resources entrusted to them to create value for the citizens they serve.⁶⁷

B. THE MOORE MODEL FOR PUBLIC VALUE

Given that there are distinct differences between the private and public sectors, the framework used to evaluate the FIAR Plan should be one geared for public organizations. Models for the private sector which focus on quantitative measures of value are too narrow in scope for application to the DoD. In 1995, Mark H. Moore, a Harvard Business School professor, wrote *Creating Public Value: Strategic Management in Government*. This work, as the title implies, is written specifically for managers in the public sector and analyzes how managers can use strategic planning to increase the value of their organizations to their stakeholders.

The Moore Model recognizes that there are various stakeholders which exert different forces upon public organizations for different reasons. He simplifies the model by categorizing stakeholders into three distinct directions; up, down, and out. Visualizing the manager in the center, he must provide value upward as defined by the political system which provides the mandates and resources to perform functions. He must provide value downward into the organization by effectively managing its operations. He must provide value outward by providing results which the public defines as valuable.⁶⁸ This relationship is depicted in Figure 4-1 below.

⁶⁷ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 16.

⁶⁸ Ibid., 17.

Moore Model For Public Organization Stakeholder Analysis

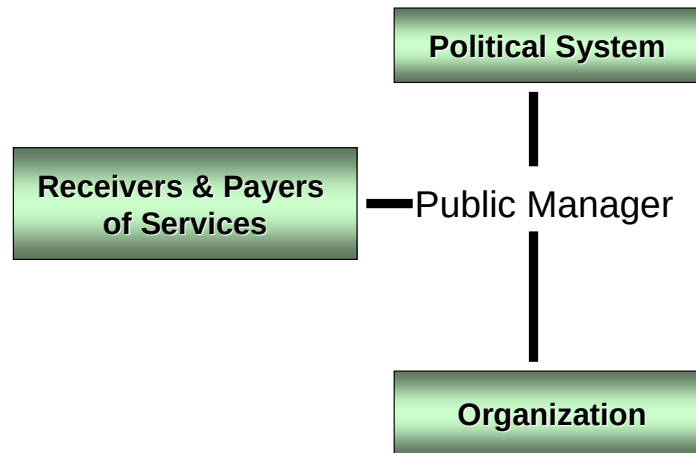


Figure 4-1. Basic Model of Public Organization Stakeholders
Source: Generated from Moore (1995)

Moore notes that the traditional role of public managers has been viewed as simply carrying out the functions as directed by the political system; no more, no less. Public managers are administrators, not innovators.⁶⁹ Their goal is to “achieve the legislatively mandated goals and objectives of their organizations as efficiently and effectively as they can.”⁷⁰ Their orientation is downward into their organization to carry out these delineated functions, often with dictated constraints. Any public value created is the by-product of carrying out the directed mission. The interactions between the various stakeholders are one-way (Figure 4-2 below). What is missing from the traditional view is the focus on the achievement of valuable results by orienting outward, and the renegotiating of policy mandates by orienting upward.⁷¹

⁶⁹ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995), 320.

⁷⁰ Ibid., 32.

⁷¹ Ibid., 17.

Moore Model For Public Organization Stakeholder Interaction (Traditional)

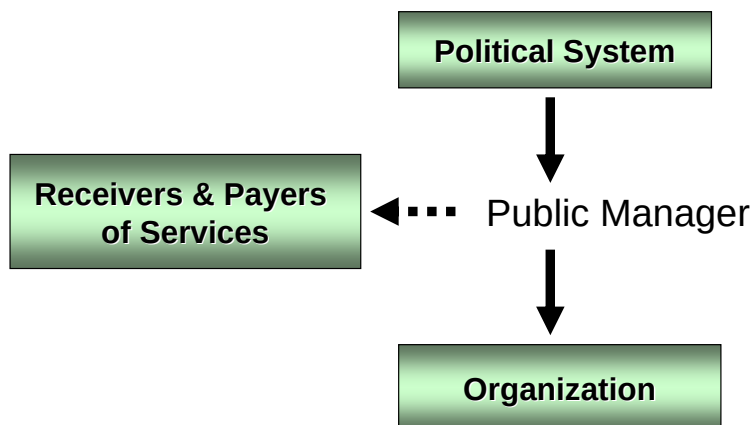


Figure 4-2. Moore Model Traditional Interactions
Source: Generated from Moore (1995)

Moore discusses how managers in the public sector can (or should) go beyond political mandates and the traditional role as an administrator, and actively seek to create value in their organization. It is an *adaptation* of a private sector mentality to a public sector environment. It is *not* a direct translation. To do this, public managers must actively engage all of the forces acting upon their enterprise. Moore states, "...in envisioning public value, managers must find a way to integrate politics, substance, and administration."⁷² To go beyond the mandate and create value requires administrators to become strategists and actively seek goals and methods to improve the value of their organization. By focusing on the traditional functions and measures of current operations, public managers can miss the opportunity to evaluate the potential benefits of doing things differently.

⁷² Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995), 22.

Moore Model For Public Organization Stakeholder Interaction (Ideal)

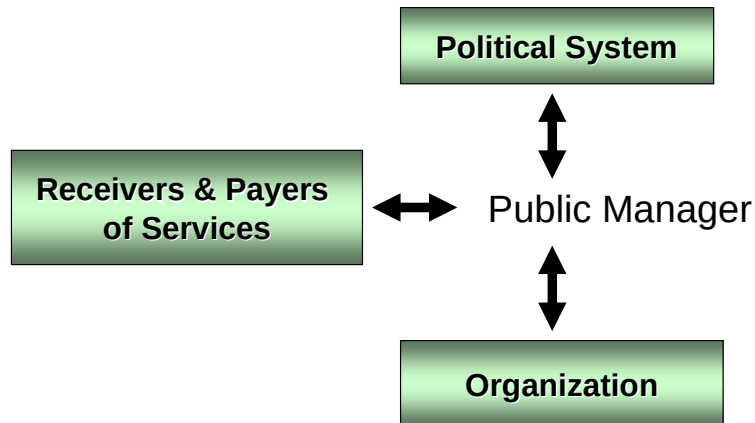


Figure 4-3. Moore Model Ideal Interactions
Source: Generated from Moore (1995)

A word of caution here; going beyond the mandate does not mean performing functions without the approval or authorization of the political system. A democratic system of government demands that public officers be held accountable to the general public. The public's will is reinforced through the election of executive and legislative bodies. These bodies add legitimacy to authorized programs and provide resources for their execution. However, managers in the public sector are (ideally) hired as experts in their field. They should have special insight into the issues, problems, solutions, and management for which their organization was created. This type of expert power should be used to interact with and influence the political system to provide mandates and resources to help managers increase the value created by their organizations. Thus, the one-way interactions of the traditional system are replaced by two-way involvement with the various stakeholders, as seen in Figure 4-3 above.

A corporate strategy for a public organization should be developed which performs the following three functions:

- Declares the overall mission or purpose of the organization;
- Offers an account of the sources of support and legitimacy that will be tapped to sustain society's commitment to the enterprise;
- Explains how the enterprise will have to be organized and operated to achieve the declared objectives.⁷³

These elements must be brought into alignment by meeting three broad tests.

- Is the enterprise substantially valuable in the sense that the organization produces things of value to overseers, clients, and beneficiaries at low cost in terms of money and authority?
- Is the enterprise legitimate and politically sustainable?
- Is the enterprise operationally and administratively feasible?⁷⁴

If an organization, or its strategy, cannot pass all three tests, then it will likely fail to deliver on its potential value and eventually lose support.

C. APPLICATION OF THE MOORE MODEL

The FIAR Plan is the DoD strategy to improve its financial systems and reporting. As discussed earlier, the FIAR Directorate is an organization inside the DoD Comptroller's office. The Directorate is more of an enabler for other DoD organizations rather than an actual producer of services. Thus, it is helpful to include in the center of the model those entities that are responsible for making the goals of the FIAR Plan a reality. This includes the BTA, USD(C), and the DoD component financial management offices. Collectively this group will be referred to as DoD FM. See Figure 4-4 below.

⁷³ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 71.

⁷⁴ Ibid., 71.

Application of Model to DoD FM

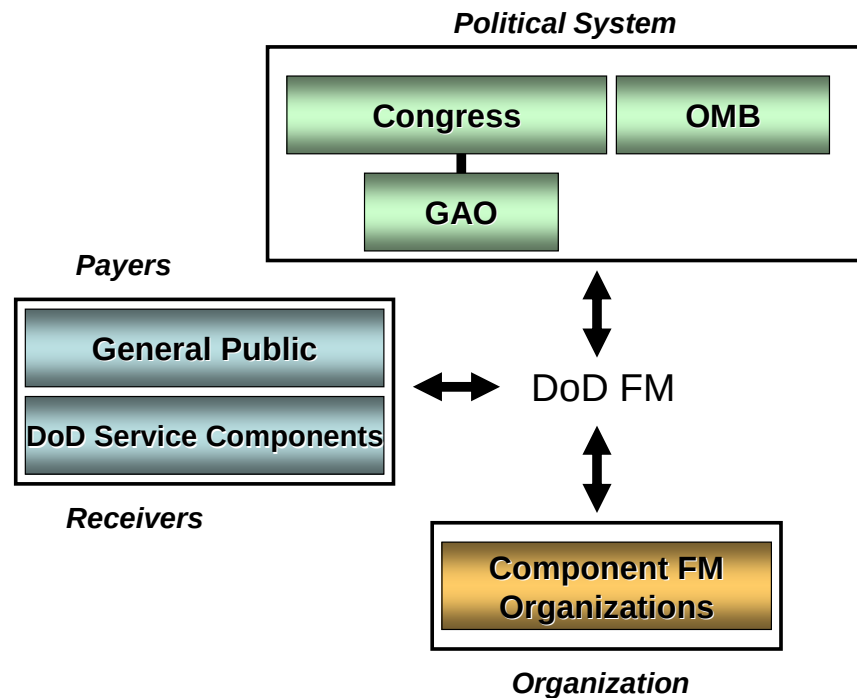


Figure 4-4. Application of Moore Model to DoD FM
Source: Generated from Moore (1995)

As the model is applied, the picture becomes more complex as stakeholders are broken out. In looking up, Congress is definitely foremost on the political side. They provide the political mandates and resources for DoD.

The GAO is placed in the political direction because of its influence on the political bodies that maintain the power. The GAO is technically part of Congress. But, it acts very much like an independent agency, issuing opinions not just to Congress, but also to the media and public. As the watchdog of Congress regarding federal agency performance, GAO reports have high visibility. Findings and recommendations by the GAO can have a noticeable impact on legislation, regulations, and policy decisions. The GAO has been delegated the responsibility to monitor compliance for applicable laws and perform the audits on the government-wide financial statements.

OMB is also considered in the political side. Laws from Congress are translated into regulations and guidance issued from OMB through devices like the OMB Circulars. It is also responsible for reporting on compliance and performance of the federal agencies directly to the President.

The DoD components are placed in the out direction because they are, or should be, receivers of the services or benefits derived from the DoD financial management community. Improved financial infrastructure should help the components conduct their tasks. Those benefits are not necessarily the same as those perceived by the general public, which is also placed in the out direction. The general public is the owner of the Department and pays for its operations through taxes. This illustrates the difference between direct clients and beneficiaries of services, and the owners of the organization. This is a fundamental point of Moore's view of a public organization.⁷⁵ This will be expounded on later.

The financial management organizations of the various agencies are in the downward direction. These are the organizations to which DoD FM must administer. While the FIAR Directorate does not have direct control over these organizations, it is responsible for the coordination of their efforts, tracking progress, and reporting results. Senior managers in the component organizations, that are responsible for their respective FIPs, should be considered part of the strategic center and provide the direct connection between the DoD FM and the component financial management communities.

It is at this point the Moore Model becomes somewhat incomplete. It does not include the interactions between the stakeholders that do not go through the manager. These bonds would include communication links such as the media and informal networks. But, they are outside the direct control of the managers in the center. For instance, there is a very strong relationship between Congress and the public. The GAO is also very vocal with the media and public with regard to financial management in the DoD. Additionally, there are formal and informal networks in existence between the component FM organizations and the

⁷⁵ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 53.

components themselves. To complete the picture of the forces at play these loops need to be closed. See Figure 4-5 below. It is important to understand these external relationships as they can be a vulnerability to success of the plan, or an opportunity to be exploited. For the purposes of presenting a more complete picture these links are recognized, but they are beyond the scope of this analysis.

“Complete” DoD FM Model

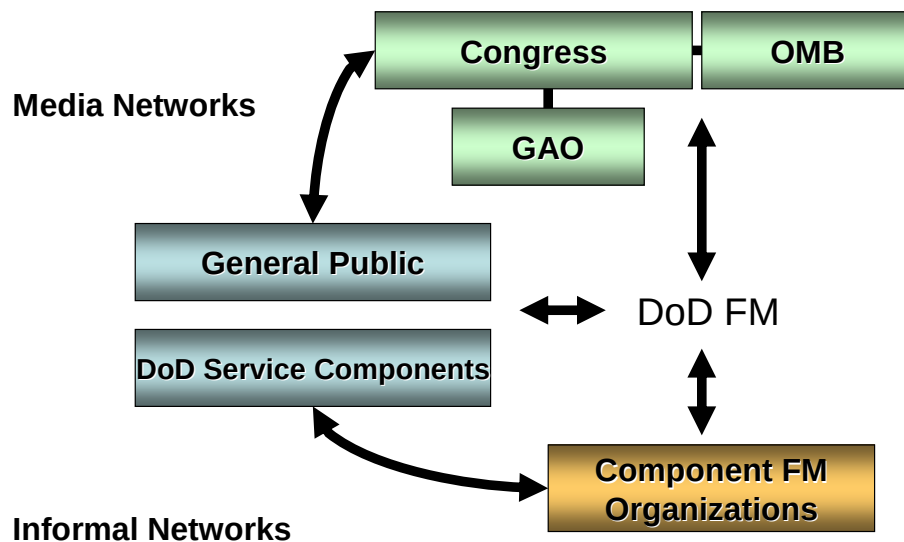


Figure 4-5. Complete DoD FM Model Showing Exterior Links
Source: Author

D. EXAMINING VALUE FOR STAKEHOLDERS

The above model lays the framework for dividing the stakeholders into focus areas. A closer examination of several of the stakeholders the DoD Financial Management community must come to terms with the following:

1. Up – Political

The integration of politics into strategic plans is essential for any public organization. This is especially true for the DoD because of the proximity and

exposure the Pentagon has with the highest levels of each of the federal government branches. It is also important because of the enormous amount of resources required for it to perform its functions.

Congress is comprised of 535 individuals who will each have varying perceptions on what they think the role of the DoD is, and how it should conduct its business. But, at some point these individuals reach a consensus and express their opinions through passage of law. Thus, legislation passed by Congress, reviewed in Chapter II, stands as the stated desires of the body with regard to the financial management requirements of federal agencies. To summarize some of the Congressional goals mentioned earlier, these requirements are:

- Production of auditable financial statements which reflect the financial position and results of operations from the agency;
- Improved compliance with accounting and reporting standards;
- Disclosure of the full cost of operations;
- Increase the capability to compare the spending of resources with the results of activities;
- Financial information produced should be complete, timely, reliable, and consistent. It should be used by the executive and legislative branches to improve decision making.

These are the political mandates that the Department must comply with. This is what Congress as a body has stated it desires.

One of the main points Moore makes about evaluating the value created within an organization is that value is rooted in the desires and perceptions of individuals. It is vital that managers understand what *stakeholders think* is valuable.⁷⁶ Furthermore, value is created through two different activities. The first is the deployment of money and authority to provide services that produce value for specific clients and beneficiaries. The second way is by operating the institution in a manner which satisfies the desires of the citizens and political

⁷⁶ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 52.

system through performance measures and accountability.⁷⁷ It is this second way which is important to focus on with regard to creating value for Congress.

By integrating the efforts of the various DoD agencies, and setting priorities at the Department level, the FIAR Plan sets in motion a strategy to achieve those political mandates which have been directed. It shows, at the very least, a commitment to move the institution in a direction to achieve compliance. The FIAR Plan, by enabling a systematic and accountable process that the DoD agencies, and the DoD as a whole, can follow to produce repeatable, auditable financial statements, will eventually satisfy the legal requirements for Congress. Additionally, the FIAR Plan can be used by the DoD as evidence that it is making an honest attempt to use the Department's resources more efficiently and effectively.

Another point that Moore brings up regarding value creation is that the operational environment will change, and public organizations must adapt to those changes.⁷⁸ One element to creating value is anticipating future benefits to authorizers, customers, and owners. As the FIAR Plan makes progress, the DoD will have at its disposal better and more accurate proprietary accounting information. This is in contrast to the budget accounting information used today. A future of solid proprietary accounting systems will open up the possibility of new thinking and new incentives. It does not have to be "business as usual." How the changes can or should change the information flow between the DoD and political leadership is not addressed in the FIAR Plan. But, there is an opportunity for the BTA and/or USD(C) to be leading the effort to ensure the maximum value is generated from the political side.

The GAO, in its role as the evaluator of federal programs, is looking to ensure the DoD, and other federal agencies are in compliance with the Congressional mandates and are performing in an effective and efficient manner. Thus, desires of the GAO are similar to those of Congress. One major goal of the Comptroller General is to be able to audit the federal government's financial

⁷⁷ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995), 52.

⁷⁸ Ibid., 55.

statements and render an opinion on its financial position.⁷⁹ Because of the problems with DoD, he will be unable to do so until the DoD can fix its problems and produce auditable statements. The GAO has issued numerous reports that repeat weaknesses in financial systems and management.⁸⁰ It is looking to see progress in addressing the problems they have reported. The FIAR Plan provides a mechanism to report that progress and refocus the efforts of components if necessary.

OMB, as the issuer of regulations, is also looking for compliance from the DoD. As the organization that reports directly to the President, they too want to ensure the organization is performing effectively.

The simple fact that there is now a more comprehensive plan for financial management reform has produced some benefits. Both the GAO⁸¹ and the DoD IG⁸² have made positive statements with regard to the FIAR Plan as being a step in the right direction. OMB recognized the potential of the Plan by raising DoD's PMA Scorecard in 'Progress in Financial Management' from "Yellow" to "Green" between September and December 2005.⁸³ While these acknowledgements may seem minor, they do indicate approval from the major players in the political arena. Provided that measurable progress can be continued and documented, support in the form of resources, political legitimacy, and negotiating power could increase with time.

Time is also an element the political side values. No one in the political arena wishes the FIAR Plan to be an open-ended program. Congress has been waiting 16 years for full compliance with the CFO Act and its amendments. According to the latest projection, they are going to have to wait another 11 years

⁷⁹ David Walker, Government Accountability Office Statement on the U.S. Government's Consolidated Financial Statements, (14 December 2005).

⁸⁰ www.gao.gov. Accessed on 6 November 2006.

⁸¹ David Walker, Government Accountability Office Testimony Before Senate Subcommittee on Homeland Security and Government Affairs, GAO-6-1006T(Washington, D.C.: USGAO, 3 August 2006). 4.

⁸² Thomas F. Gimble, Office of the Inspector General Department of Defense Testimony Before Senate Subcommittee on Homeland Security and Government Affairs, (3 August 2006).

⁸³ www.whitehouse.gov/results/agenda/scorecard.html. Accessed on 6 November 2006.

until 2017.⁸⁴ It has been stated that the FIAR Plan is a results driven plan, and not timeline driven. Yet, timelines are used extensively in the written documents. This has led to some confusion on Capitol Hill.⁸⁵ By listing timelines then not meeting deadlines or moving deadlines to the right without explanation creates the impression that either the plan or the execution is flawed.

One case in point is going back to the 5-years projections for clean opinions on assets mentioned in Chapter III. See Figure 4-6 below. In the December 2005 release, 42% of the DoD's assets were projected to have a "clean" opinion in 2006.⁸⁶ This was based on the Military Equipment line item achieving the opinion. The September 2006 release shows an updated projection of 15% of assets having the "clean" opinion in 2006. No change from 2005. The Military Equipment line item now shows a 2009 date for audit.⁸⁷ There may be a very good reason why that item needed to be moved to the right. However, no explanation was given for the delay. This was one of many examples of changes between the two releases. These changes, and some are quite dramatic (such as Defense Logistic Agency's date for audit in the Other Liabilities category shifting three years)⁸⁸, can lead political leadership to question the validity or sincerity of the plan. Value that was achieved could quickly be lost.

⁸⁴ Defense Financial Improvement and Audit Readiness Plan (September, 2006) 39.

⁸⁵ Senate Homeland Security and Governmental Affairs, Federal Financial Management, Government Information and International Security Subcommittee on Financial Management at the Defense Department Hearing (3 August 2006).

⁸⁶ Defense Financial Improvement and Audit Readiness Plan (December 2005) 8.

⁸⁷ Defense Financial Improvement and Audit Readiness Plan (September 2006) 1-3.

⁸⁸ Ibid., 40.

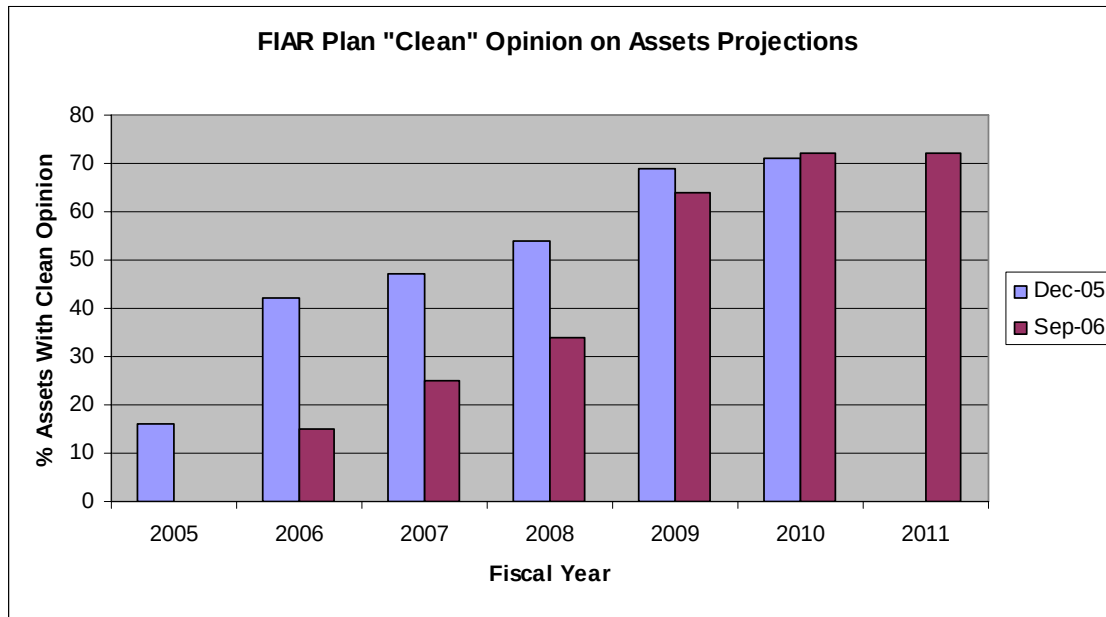


Figure 4-6. FIAR Projections for Assets
Source: Generated from December 2005 and September 2006 FIAR Plans

2. Out – Substance

Looking out requires examining the two activities that a public organization is responsible for; running an institution that is in keeping with the expectations of the owners, and providing goods and services directly to clients and beneficiaries. For the purposes of this analysis, the principle stakeholder analyzed with the former is the general public. The direct clients and beneficiaries of DoD financial management are the Department's individual services and agencies. It would be a valid argument to claim that there are many other clients and beneficiaries outside of the Department, such as contractors, other government agencies, foreign governments, etc. However, these other stakeholders were not considered for purposes of simplification.

If the premise is accepted that the effective running of a public institution is a reasonable *requirement*, then it follows that the administration of the organization is equally as important as the operations. The ability to be able to justify the actions and processes of the organization is just as critical as the

actual services it provides is another point Moore makes.⁸⁹ For the DoD, every tax paying American citizen is an “owner” in the organization. The perceived benefits of DoD operations can vary greatly between these individuals. For example, some communities in which military bases are located benefit directly from the application of authority and resources from the Department. Their local economy and local government can be heavily supported by Defense spending. On the other side, members of some communities throughout the country that have no direct dealings with the Department may see no direct influences on their daily lives. But, everyone still has a stake in how the organization is run. They are paying for it. And therefore, the DoD has an obligation to show that it is using the resources provided by the public as a whole effectively and fairly. Financial visibility is *one* window in looking at how the DoD uses those resources.

The FIAR Plan, through the improved financial reporting, is intended to provide better visibility in how the DoD is using its resources. Auditable financial reports are *one* element in providing verifiable proof that the DoD is conducting business in a manner which the public expects. With the DoD’s inability to maintain timely, accurate, reliable and verifiable financial information, confidence in the institution’s ability to perform its functions effectively is eroded, and the value created through operations can be called into question.

To illustrate the difference between performing a function and accounting for it, following the devastating Katrina hurricane affected citizens demanded immediate assistance. One of the solutions to alleviate hardships was for the Federal Emergency Management Agency (FEMA) to distribute money through checks and debit cards to affected individuals. Over \$5 billion in financial aid was distributed to victims. Without the proper financial systems in place, proper planning, and firm controls, FEMA could not reasonably assure that payments were being made to individuals qualified to receive those funds. Billions of dollars

⁸⁹ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 54.

in federal assistance may have been paid to fraudulent claimants.⁹⁰ This was one of many FEMA programs that came under fire in the wake of the storm.⁹¹ The inability of FEMA to account for its actions and maintain financial controls led to an erosion of trust by the public in the ability of the organization to perform.

The preceding example was an extreme case. But, it goes to the point that providing a service and accounting for it are two distinct functions. Citizens needed the direct benefits of services from FEMA in the form of emergency cash. FEMA did just that and distributed funds. By not having the right systems and controls in place to account for its actions, the positive actions of the agency were countered by the questioning of the process.

Do financial statements by themselves create this public confidence? The answer is likely, no. The vast majority of the public will never read the DoD financial statements, let alone understand them. It is the opinion that creates the value. It is the independent evaluation from a trusted agent that verifies that the DoD is operating as it should that is important. That is the necessity of gaining an unqualified opinion on the financial statement.

But, the value creation goes a little further than that. While consolidated financial statements give validity to the big picture at the Department level, with solid financial systems working efficiently across the Department, each agency can better justify its individual financial decisions to the public and political authorizers. With the systems and controls in place that are required to attain an unqualified opinion, individual managers will be in a better position to prevent waste and abuse, and verify that their financial decisions are based on firm data. An unqualified opinion adds credibility to the financial decisions made.

The FIAR Plan creates value for the public in two ways. First, it is an enabler for the DoD and its agencies to get their financial systems in order and attain independent unqualified opinions. Second, it provides a single plan which can be displayed to owners and authorizers that problems are being addressed

⁹⁰ U.S. Government Accountability Office, *Expedited Assistance for Victims of Hurricanes Katrina and Rita: FEMA's Control Weaknesses Exposed the Government to Significant Fraud and Abuse*. GAO-06-403T (Washington, D.C.: USGAO 13 February 2006).

⁹¹ Eric Lipton. 'Breathtaking' Waste and Fraud in Hurricane Aid in The New York Times. (New York, NY: 27 June 2006) A1.

and progress is being achieved. Such a presentation is easier for an audience to comprehend than having DoD officials explain the progress of 10 separate plans. Such recognition was noted above from the GAO and DoD IG.

Focusing outward also requires looking at the desires and expectations of clients and beneficiaries. With regard to the DoD's financial management community, these clients are the major DoD components. The desires of the components are probably quite different from the stakeholders examined above. For them it is the fighting of the nation's wars and carrying out the policies of the President that is the primary focus. While mission accomplishment may be focus of uniformed leadership, finances permeate every aspect of the DoD's operations, support, and administration. The service DoD FM provides is supporting the services operational tasking and training.

Leaders of the service components are faced with tough financial decisions. With the increases in entitlement spending in the coming years, pressure on the top-line will continue to grow.⁹² Budgets are becoming tighter, operations are becoming more expensive, and equipment is getting older and is in need of replacement. Leadership is continuously facing the choice of modernizing the financial systems or buying much needed equipment for operational forces. The short term answer may be to put off system modernization until later. That, however, may have long-term consequences.

As it stands now, none of the services have financial information systems which can provide timely, reliable, and accurate information on a consistent basis. These systems provide the data that all levels of management use to make decisions, up to and including the President and Congress. This leaves open the door for decisions and performance to be questioned. Uniformed leaders do have a stake in financial improvement. And, they should be concerned that the information they currently have cannot be confirmed to be timely, reliable, or accurate.

There are many business transformation efforts underway throughout the services. These involve not just finances, but also include logistics, supply, and

⁹² Congressional Budget Office. *The Budget and Economic Outlook: An Update*. (Washington, D.C.: August 2006) 20.

management. The main purpose of all of these enterprise transformation efforts is to improve business processes and make the organizations more efficient so resources can be used for other objectives like recapitalization. But, the underlying foundation for any process improvement that involves cost as a metric is financial. The current budget accounting used by DoD does not fully support the information requirements to perform the types of analysis that would generate the maximum benefit.

A specific case involves the Navy's program for business transformation within the naval aviation community, the Naval Aviation Enterprise (NAE). The NAE seeks to transform the business processes within the naval aviation community to improve readiness and responsiveness. The stated goals of the NAE are:

- Balance current and future readiness;
- Reduce costs and improve “product per dollar” to naval aviation;
- Enhance organizational agility;
- Maintain and improve alignment with the CNO;
- Implement Fleet driven metrics;
- Attain and maintain visibility across the enterprise.⁹³

The main purpose of reducing costs is so that savings can be redirected into recapitalization.⁹⁴ Much of what NAE leadership needs is financial in nature. Interviews indicate that NAE leadership is aware of the financial systems shortfalls, but upgrades are not currently the major priority. In order to reduce costs, they must first be understood and known. Budget accounting systems do not support the kind of data required to make the optimal decisions necessary to satisfy the objectives.

The Navy ERP should provide a financial reporting foundation with the timely and relevant information to build the managerial accounting system(s) the NAE could apply for cost reductions and process improvements. The NAE is the

⁹³ Commander Naval Air Forces, Naval Aviation Enterprise, <http://www.cnaf.navy.mil/nae/content.asp?AttachmentID=182#448,4,Slide 4>. Accessed on 11 November 2006.

⁹⁴ Ibid., Slide 13.

most mature of several enterprises within the Navy. It would be to the uniformed leadership's advantage to encourage and incorporate these financial improvements so they will have better financial information on which to formulate their decisions.

In the DoD adaptation to new purposes and requirements is very difficult to recognize, resource, and manage. The pace of the changing environment is also getting quicker with technological advancements, the rise of a new world order following the end of the Cold War, and the evolution of the 24-hour news cycle, all of which further complicate matters. With regard to financial management, the solution in the past was to create unit-specific financial systems and processes. While it looked like an efficient way to get things done at the lowest level, the end result has been the creation of a multitude of systems that actually stifles the ability of the DoD to adapt and change at all levels. The creation of business standards like the BEA and SFIS implemented by the FIAR Plan, as discussed in Chapter III, should help to lay a foundation for changes to be incorporated in a manner that suits the needs of users at all levels and in all services.

As was mentioned before, the integration of proprietary accounting systems into the DoD should open up the possibilities of doing business differently than before. Solid financial data provide the foundation for managerial or cost accounting systems. These can greatly aid in finding and reducing non-value added activities, and improve controls so there is waste. The benefit for the service components are better use of scarce resources, a increased ability to recapitalize, and a better standing with the public and political authorizers. Continued progress with the FIAR Plan should help make that a reality sooner.

A concept that non-financial managers may not fully grasp is that the financial reporting problems in the Department are not wholly accounting problems. The financial management community tracks financial information. They do not generate it. As one financial manager put it, "We count the beans, we don't make them." This is another common theme from discussions with all of the senior financial managers interviewed. The non-financial elements of the

Department, who actually generate the transactions and feed the information into the financial systems, are part of the problem. This includes those involved with logistics, supply, human resources, contracting and acquisitions. They have to be part of the solution. This element is not explicitly stated in the FAIR Plan. But, the service FIP managers do recognize this and are working to address this issue themselves. All stated that progress has been made on improving awareness among the uniformed leaders, but that there is much to be done.

One thing that is understated in the FIAR Plan is the need for *relevant* financial information. The relevancy of information is mentioned only once in the September 2006 FIAR Plan. The emphasis is on timeliness, reliability, and accuracy which are important terms for auditability. But, the customers of DoD FM need relevant information. The financial managers interviewed stated they are addressing relevancy through their FIPs. But, it should probably be more prominent in the FIAR Plan itself.

3. Down – Administration

In order to create the value for others, someone or something has to do the work. Top level managers and leaders have to give their people the tools and incentives to make things happen. The financial management community in the Department has an enormous task with improvement efforts. While improvement efforts are underway, they still have to support their commands with current operations.

The FIAR Plan supports the FIPs of the DoD agencies. The Air Force FIP is called the Air Force Information Reliability and Integration (AFIR&I) Action Plan. Their supporting integrated financial system being developed is called the Defense Enterprise Accounting Management System (DEAMS). The Army's FIP is called the Future Business System (FBS) and its integrated financial system is called the General Fund Enterprise Business System (GFEBS). The Navy's FIP is incorporated into one comprehensive program called the Navy Enterprise Resource Planning (ERP) program.⁹⁵

⁹⁵ Business Transformation Agency, Enterprise Transition Plan. Available at http://www.dod.mil/dbt/products/Sept-06-BEA_ETP/etp/ByCategory.html. Accessed on 9 November 2006.

What the FIAR Plan provides to DoD financial managers is a common framework for long range planning of requirements. It also provides standard processes for all of the agencies to prepare for their audits once the system objectives are complete. It combines the systems transformation with audit preparedness. But, it also allows the different agencies to configure their systems to meet their unique requirements. This positive aspect of the FIAR Plan was a common theme discussed among the senior financial managers.

One of the principles of the FIAR Plan is to integrate the transformation programs across the components. A comment that was common to most of the financial managers was that while the FIAR Plan required some interaction among the services, there is room for improvement. The services appear to be working on their respective KMPs according to the Plan, but they are not working together. There is an advantage to that which will be discussed in the next chapter. But, FIAR Plan managers should look for additional opportunities to leverage the experience between the components. Done with some strategic forethought, better interaction might help to reduce the time and costs of fixing systems, using the information more effectively, and getting the assertion for audit quicker.

When asked if their financial managers were prepared to handle and use effectively the information available from a proprietary accounting system, most of the senior financial managers responded that their people were currently not proficient with that type of information. The FIAR Plan is a systems and process geared plan. But, as these new systems come on line, people have to be made capable of being able to configure the systems to make them worthwhile. Otherwise, the true value that would be created from these efforts will not be realized. As was stated in the Friedman Report, "...it is possible to reach the goal of reliable financial information and a clean opinion and still not have information that is relevant to managers."⁹⁶ As the DoD becomes CFO Act compliant and achieves an unqualified opinion, relevancy may be compromised. That means transforming people is just as important as transforming systems.

⁹⁶ DoD Report, "Transforming Department of Defense Financial Management: A Strategy for Change" (13 April 2001) iii.

Changing DoD financial managers from a budgetary accounting mindset to a proprietary accounting mindset is important for several reasons. Some of which will be covered in the next chapter. But, it will be critical for users of these new systems to understand how they work in order to obtain and sustain unqualified opinions. Additionally, the value benefits mentioned above will not be realized if people do not understand what information they need or what information they are looking at. The FIAR Plan is not explicit about a people/training/education strategy. That was not one of the material weaknesses listed by the DoD IG. However, the USD(C) and the other agencies should be looking ahead to prepare their people to operate in what will be a new world for them.

E. CONCLUSION

The Moore Model of a public organization focuses on stakeholder interests and examining what they perceive as value added activities. Value is created through the integration of politics, substance, and administration. Bear in mind that value creation does not necessarily involve just meeting stated desires. It also involves using expert knowledge to influence those desires.⁹⁷ Public managers need to also be good marketers.

In summing up value elements created through the FIAR Plan, these are the items inherent in the Plan.

- Provides a roadmap for compliance with Congressional mandates and OMB regulations;
- Provides a comprehensive framework for component FIP managers to follow;
- Enforces standards to ensure consistency across the Department;
- Demonstrates progress to overseers and the public;
- Improves systems to provide better information for decision making.

Additional value that is either not inherent in the Plan or could be a future focus includes:

⁹⁷ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 75.

- Working with political leadership to take advantage of future financial visibility. Regulations and incentives need to be addressed with political leadership to encourage innovation.⁹⁸ Active engagement of the political system is also a tenet of Moore.⁹⁹
- Improved visibility to changes in the Plan so overseers have less reason to question the sincerity or execution of the Plan. The Friedman Report pointed out that the DoD has developed a credibility problem with all of its stakeholders with regard to financial management.¹⁰⁰ Full visibility is step toward building back credibility.
- Seeking progress metrics that non-financial managers can understand and appreciate. If support from outside the financial management community is desired, then an effort to include accomplishments outsiders will understand will help.
- Make the relevance of financial information just as important as the timeliness, accuracy, and reliability of it.
- Including the transformation of financial managers as people to handle the transformation of systems and processes. Solid financial systems will provide data. But, people have to be capable of using that data in order to make it valuable.

This is not an all inclusive list, rather, a foundation for further examination and discussion.

Finally, an examination of Moore's three tests is warranted to complete the assessment and get a sense if the FIAR Plan is a viable strategy.

- Is the enterprise substantially valuable in the sense that the organization produces things of value to overseers, clients, and beneficiaries at low cost in terms of money and authority? Yes. As the preceding evidence indicates, the FIAR Plan does produce value for the DoD and its stakeholders. But, that value may not be recognized by some beneficiaries. As for its cost, it is currently within the bounds of acceptability as the Plan and the FIPs it supports are currently funded. That is a risk factor which will be examined in the following chapter.

⁹⁸ DoD Report, "Transforming Department of Defense Financial Management: A Strategy for Change" (13 April 2001) iii.

⁹⁹ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 75.

¹⁰⁰ DoD Report, "Transforming Department of Defense Financial Management: A Strategy for Change" (13 April 2001) ii.

- Is the enterprise legitimate and politically sustainable? Yes. The FIAR Plan currently has the support of Congress, the GAO, the DoD IG, and OMB. It should be noted that political sustainability does not guarantee the plan can be executed over the long-term. That is the subject of the next chapter.
- Is the enterprise operationally and administratively feasible? Yes. Producing auditable financial statements and obtaining an unqualified opinion is not an impossible task. Several federal agencies and thousands of private companies have already done it. It is a matter of time, resources, and commitment.

V. FIAR PLAN SUSTAINABILITY

The following chapter seeks to address the second major question; can the changes required of the FIAR Plan be sustained over the long-term? This is accomplished through application of the FIAR Plan to a framework designed for examining changes processes. From this, a risk assessment can be made concerning the risks associated with the FIAR Plan's long-term sustainability.

A. RATIONALE FOR EXAMINING SUSTAINABILITY

The previous chapter shows the FIAR Plan has the potential to create value for the various stakeholders. However, if it is a plan which cannot be executed and sustained over the long term, then its value comes into question. Considering the amount of resources and time put into the program, it could be argued that its failure would drain value from the organization. It is not enough to have noble goals and plans. At some point the value in a plan has to be realized through the achievement of intermediate goals and an effort that is sustained through completion.

Moore states that sustainability is critical for any strategy to succeed.¹⁰¹ Thus, this is an issue which deserves further examination. The Moore Model does not comprehensively address sustainability. The FIAR Plan is a change process. Its concentration is on changing systems and processes. But, those changes require support from stakeholders. Numerous works of academic research have been conducted on organizational change, which include both private and public sector studies. However, the findings lack full adaptation to the DoD and the unique environment it operates in. One recent study provides a good basis for evaluating the sustainability of the FIAR Plan.

B. THE FERNANDEZ/RAINEY MODEL

Sergio Fernandez of Indiana University and Hal Rainey of the University of Georgia released a study in the summer of 2006 entitled "Managing Successful Organizational Change in the Public Sector: An Agenda for Research and

¹⁰¹ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 71.

Practice.”¹⁰² This study was a compilation of many works dealing with change at the organizational level. It includes references to studies that dealt with both the private and public sectors. However, their conclusions were geared specifically for the public side.

Fernandez and Rainey included elements from many different academic theories on the change process. These were:

- **Rational adaptive theories:**¹⁰³ Propose that change is driven by a manager's purposeful action by analyzing the organizational environment and making necessary changes to the structure and processes to match that environment.
- **Institutional theories:**¹⁰⁴ Argue that organizations exist in an environment “populated by public and private stakeholders and authorities, and the norms, values, rules, and cognitive systems they uphold.” It is conformity to those norms that drives change. Therefore, for an organization to change, society must change. Or, that change must be dictated by legitimate authority.
- **Life cycle theories:**¹⁰⁵ Suggests that change is natural and spontaneous as the organization moves through phases of development. Change is inherent within the organization. Resistance and acceptance of change are represented as rigidity and adaptation cycles, respectively.
- **Ecological and evolutionary theories:**¹⁰⁶ Similar to life cycle theories, ecological and evolutionary theories hold that purposeful action is limited in its effectiveness. Organizations will naturally adapt to the environment. Those that do not will perish.
- **Policy diffusion and innovation models:**¹⁰⁷ Holds that public managers seek changes that emulate their peers. They do this for three reasons: to learn and borrow successful ideas and practices; to be competitive; and to satisfy public demand for policies which mirror others.

¹⁰² Sergio Fernandez and Hal Rainey. “Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice” in *Public Administration Review*. (March/April 2006)

¹⁰³ Ibid., 3.

¹⁰⁴ Ibid., 3.

¹⁰⁵ Ibid., 4.

¹⁰⁶ Ibid., 4.

¹⁰⁷ Ibid.

- **Dialectical and conflict theories of change:**¹⁰⁸ Organizations exist in a pluralistic world with conflicting interests, ideas, and values. It is through confrontation and conflict that new ideas and value emerge to challenge the status quo, and ultimately replace it.

From their synthesis of studies conducted using these theory types, Fernandez and Rainey developed eight factors to successful change in the public sector. These factors are geared specifically toward, "...large-scale, planned, strategic, and administrative changes – of the sort now often referred to as organizational transformations in large organizations such as general purpose government agencies or city and county governments."¹⁰⁹ The FIAR Plan, and the DoD organization in which it was designed to influence, fits this condition. The change sustainability factors are:

1. **Ensure the need.**¹¹⁰ Managerial leaders must verify and persuasively communicate the need for change. This communication should be a continual process to as many stakeholders as possible. Efforts should be made to take advantage of mandates, political windows of opportunity, and external influences to verify and communicate the need for change.
2. **Provide a plan.**¹¹¹ Managerial leaders must develop a course of action or strategy for implementing change. Visions must be translated into a pragmatic plan with achievable goals. Organizations need direction. This is so, "...the transformation does not disintegrate into a set of unrelated and confusing directives and activities."¹¹²
3. **Build internal support for change and overcome resistance.**¹¹³ Managerial leaders must build internal support for change and reduce resistance to it through widespread participation in the change process and other means. Internal political structures can be a major road block to the change process. Fernandez and Rainey warn, "...reform movements in government, in which reformers prescribe major organizational changes for government agencies, can aggravate the problem of resistance to changes."

¹⁰⁸ Sergio Fernandez and Hal Rainey. "Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice" in *Public Administration Review*. (March/April 2006), 5.

¹⁰⁹ Ibid., 6.

¹¹⁰ Ibid., 8.

¹¹¹ Ibid., 9.

¹¹² Ibid.

¹¹³ Ibid., 10.

Furthermore, “reforming may be no more than a governmental fashion statement...with highly superficial impact.”¹¹⁴ Fernandez and Rainey cite the possible need for portraying a shock or crisis to help decrease resistance.

4. **Ensure top management support and commitment.**¹¹⁵ Top managers should take on the role of change agent or idea champion or actively support the person or group that is designated. Fernandez and Rainey also note that in the public sector, top level support must come from both the political and civil-service leadership.
5. **Build external support.**¹¹⁶ Managerial leaders must develop support from political overseers and key external stakeholders. Public organizations often have multiple political overseers with different affiliations that wish to pursue different agendas. Gaining support is a challenge, but necessary to ensure availability of resources and prevent roadblocks from legislation or regulation. Managing the interest group environment was found to be critical. Opposition from such groups can force modifications to plans which can increase costs and/or threaten the success of the change process.
6. **Provide resources.**¹¹⁷ Successful change requires sufficient resources to support the process. Changes at the organizational level require a commitment of non-trivial resources; both in terms of money and manpower. Those efforts that are not fully funded tend to fail.
7. **Institutionalize change.**¹¹⁸ Managers and employees must effectively institutionalize changes. Not only should systems and processes be changed, but also behavior. Without institutionalizing the changes, employees will revert to old behavior patterns. The pace of change can be critical. Studies are mixed on the effectiveness of rapid vs. incremental change. Fernandez and Rainey note that incremental changes could be risky in a public organization due to the frequent turnover of political leadership.
8. **Pursue comprehensive change.**¹¹⁹ Managerial leaders must develop an integrative, comprehensive approach to change that

¹¹⁴ Sergio Fernandez and Hal Rainey. “Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice” in *Public Administration Review*. (March/April 2006), 10.

¹¹⁵ Ibid., 12.

¹¹⁶ Ibid., 14.

¹¹⁷ Ibid.

¹¹⁸ Ibid., 15.

¹¹⁹ Ibid., 16.

achieves subsystem congruence. Examples of subsystems include recruitment, training, incentives, structural, information, and control systems. These subsystems are interdependent and must be brought into balance when trying to make organizational changes.

C. BROOK STUDY OF FEDERAL GOVERNMENT AUDITED FINANCIAL STATEMENTS

Fernandez and Rainey point out that their paper was based on academic findings of previous studies. They recommend further study on the subject of sustained change in the public sector. But, an independent study published in 2001 by Douglas Brook entitled “Audited Financial Statements: Getting and Sustaining “Clean” Opinions” dealt specifically with the change process with regard to financial management and financial statement production in the federal government. This study provides a reasonable test of the validity of using the Fernandez/Rainey factors on a federal organization like the DoD.

Brook’s study examined the correlation between organizational characteristics and audit opinions for the financial statements of the 24 CFO Act agencies between 1996 and 1999. He identified six characteristics which were common in those agencies that were able to successfully achieve clean opinions. Those characteristics were:

- Demonstrated senior leadership commitment;
- Positive resource allocation;
- Positive working relationships between financial managers and auditors;
- Positive cooperative arrangements between financial and line and functional managers;
- Short-term “work-around solutions” applied;
- Application of extraordinary effort to key problem areas.¹²⁰

These characteristics are consistent with the factors identified by Fernandez and Rainey. It appears that the roles of leadership, adequate resources, and internal and external relationship management are critical to sustained success.

¹²⁰ Douglas A. Brook. “Audited Financial Statements: Getting and Sustaining “Clean” Opinions”. PricewaterhouseCoopers (July 2001) 29-34.

The last two characteristics, work-around solutions and extraordinary effort, were cases in which the agencies had problem areas which could be solved with short-term efforts. According the Fernandez and Rainey, these short-term efforts can be used to build internal and external support and break resistance.¹²¹ Brook noted that some agencies used work-around systems designed to produce auditable statements, however they were not designed to provide useful information for management decisions.¹²² So, using these techniques can be risky to long-term goals if not managed properly.

The Brook study provides confidence that application of the Fernandez and Rainey factors for sustained changed are valid for applying to the DoD and the FIAR Plan.

D. FIAR PLAN SUSTAINABILITY RISK ASSESSMENT

The question of whether or not the FIAR Plan can be sustained through completion is not a question that can be answered with any amount of certainty. There are too many variables that can affect the success of a change strategy. Also, the importance, or criticality, of these variables will change over time, and in an indeterminate manner. Therefore, it is better to examine the problem by evaluating the Fernandez/Rainey success factors for sustained changed in terms of the risk DoD currently has that they can satisfy the factor.

Table 5-1 below is a scorecard that rates each of the sustainability factors in terms of the risk they reveal to sustaining the FIAR Plan over the long-term. This is a subjective evaluation of the factors based on observations of the DoD FM environment. Justifications for the risk rankings follow.

¹²¹ See Fernandez and Rainey Factors #3 and #5, 68.

¹²² Douglas A. Brook. "Audited Financial Statements: Getting and Sustaining "Clean" Opinions". PricewaterhouseCoopers (July 2001) 34.

FIAR Plan Sustainability Scorecard

Factor	Risk	Support Elements
1 Ensure The Need	Med	Congressional Legislation (Law) GAO Reports DoD IG Audits OSD Priority
2 Provide A Plan	Low	FIAR Plan Components FIPs Enterprise Transition Plan/SFIS
3 Internal Support	Med	Component FIPs ASMC CDFM Certifications Component FM Training
4 Top Management Support	High	Political/Civilian/Military Leadership Structure
5 External Support	High	Operational Side of Services Congress GAO OMB
6 Provide Resources	Med	Budget Funding For FIAR/FIPs
7 Institutionalize Change	Med	Size of Organization Reliance on Components Incremental Pace
8 Comprehensive Change	Med	FIAR Plan Relation With BTA

Table 5-1. FIAR Plan Sustainability Scorecard
Source: Author

1. Ensure the Need – Medium Risk

The need for financial management reform and the ability to produce auditable financial statements has been expressed repeatedly by many different sources. Congress has expressed the need through the various legislation they have passed over the years. These laws carry more than just the desires the Congress and the public at large which they represent. They are requirements

that *must* be met. Thus, there is no shortage of political legitimacy for the change. Additionally, members of Congress have held numerous public committee hearings investigating the issues around financial management reform in the DoD.¹²³

The GAO publishes an almost continuous stream of reports related to financial management in the Department. Over 58 reports were released by the GAO with financial management within the DoD as part of the issue.¹²⁴ Most include the need to improve financial processes and systems, and recommendations to increase the likelihood of auditability. In many public appearances in the past few years, the Comptroller General David Walker stated he could not verify the soundness of the U.S. Government's financial position until the DoD was able to receive a comprehensive audit.

The DoD IG also publishes reports every year stating the need to make progress in financial management reform. The most visible of these is the Inspector General's statement included in the DoD's Performance and Accountability Report. For the FY2005 report he stated, "The Department faces financial management challenges that are complex, long-standing, and pervade virtually all its business operations, affecting the ability to provide reliable, timely, and useful financial and managerial data to support operating, budgeting, and policy decisions."¹²⁵ The GAO and DoD IG represent external sources that reinforce the need of change.

All of the above represent using political windows of opportunity for communicating a need.¹²⁶ So, the word is getting out. But, the question becomes, how is this information being received by DoD? There are risks with

¹²³ Senate Homeland Security and Governmental Affairs, Federal Financial Management, Government Information and International Security Subcommittee on Financial Management at the Defense Department Hearing (3 August 2006).

¹²⁴ www.gao.gov. Accessed on 6 November 2006.

¹²⁵ DoD Performance & Accountability Report FY2005, Part 4: Inspector General's Summary of Management Challenges. 294.

¹²⁶ Mark A. Abramson and Paul R. Lawrence. "The Challenge of Transforming Organizations: Lessons Learned about Revitalizing Organizations." In *Transforming Organizations*, ed. By Mark A. Abramson and Paul R. Lawrence. (Lanham, MD: Rowman & Littlefield, 2001) 1-10.

ensuring the need for financial management reform remains a focus. This is because of the mixed signals many of the above entities make. While Congress has made auditable statements a mandated requirement since 1990, no one has been fired for failing to receive an unqualified opinion. The DoD also receives its funding every year. While Congress may enact cuts to the proposed budget, they are not due to non-compliance with CFO Act legislation. The main focus of DoD and Congressional leaders is with policy and operational issues, not financial management. There is no apparent penalty for failure which provides an incentive to do nothing, or as little as possible.

People associated with the DoD have been hearing about this need for audited statements for over 16 years. The message could be lost in what has become a broken record. Congress still passes a budget every year, and everyone still got paid. Tanks still rolled, planes still flew, and ships still sailed. Every supplemental budget request was passed. It is not hard to see why many would question the need for compliance.

Ensuring the need for the FIAR Plan will require more than just the CFO Act. It is going to require an extensive strategic communication plan.¹²⁷ Every target audience will receive the message differently because of the differences on their desires and perceived benefits from the plan. Therefore, managers associated with the FIAR Plan must be flexible and cognizant of the methods, media, and presenters they use. This is an element which must be continuously emphasized.

2. Provide a Plan – Low Risk

Fernandez and Rainey describe the goal to “plan strategically but pragmatically.”¹²⁸ The FIAR Plan seems to fit that description. It lays out clear, systematic intermediate goals (key milestones) on the path to achieving an overarching objective (an unqualified opinion on the DoD consolidated financial

¹²⁷ Achilles A. Armenakis, Stanely G. Harris and Hubert S. Field. “Paradigms in Organizational Change: Change Agent and Change Target Perspectives.” In *Handbook of Organizational Behavior*, ed. By Robert T. Golembiewski. (New York: Marcel Dekker, 1999) 635.

¹²⁸ Sergio Fernandez and Hal Rainey. “Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice” in *Public Administration Review*. (March/April 2006), 9.

statements). It leverages two important elements. The first is the production of DoD-wide business standards through the ETP, and the financial standards provided by SFIS. The second element is the component FIPs. The FIAR Plan does not attempt to redo the progress already made by the components. It provides a framework for the different components to focus their efforts toward more common goals. The FIAR Plan is but one part of other business and governmental transition plans. It may

3. Build Internal Support – Medium Risk

A major risk with internal support amongst the financial management community is a perception that the FIAR Plan may be just a “governmental fashion statement.”¹²⁹ Internal leaders, managers, and employees need to be assured that this plan is more than window dressing. Internal support relates closely to the first two factors. Leaders must continuously verify the need, and provide a workable plan so personnel internal to the process believe that their work brings meaningful change.

One useful tool to aid in the bolstering of the internal support of the DoD financial management community is through the American Society of Military Comptrollers (ASMC). ASMC is a non-profit professional organization for DoD and Coast Guard financial managers. It has over 18,000 members and 140 chapters world-wide¹³⁰. Every year the organization holds a Professional Development Institute (PDI) Conference to provide common training and education opportunities to its members. At the 2006 PDI Conference held in San Diego, CA, 108 workshops were conducted. Of these, 25 or 23% dealt with the FIAR Plan, business transformation, or auditability.¹³¹

In addition to the PDI, ASMC publishes a quarterly journal, *The Armed Forces Comptroller*, which shares information related to DoD financial issues with members. The last four issues of the magazine (Summer 2005-Spring 2006)

¹²⁹ Sergio Fernandez and Hal Rainey. “Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice” in *Public Administration Review*. (March/April 2006), 10.

¹³⁰ www.asmconline.com. Accessed on 20 October 2006.

¹³¹ Ibid.

contained no less than 12 articles, written by DoD financial managers, about business transformation issues or financial improvement plans throughout the DoD.

One of the characteristics of the FIAR Plan, as has been noted before, is the use of independent component FIPs. This has led to some duplication of effort and what might appear as an inefficient use of resources. For example, the Army, Navy, and Air Force have each made separate contracts with different companies for consulting, software, and hardware. Had the decision been made to formulate one DoD-wide transition plan, it is likely the process would have been mired in inter-service negotiations to come up with a compromise plan for all organizations. Such a plan may have ended up being less than optimal for all of the services. By allowing each service to maintain its own plan and see to its own unique needs, the FIAR Plan has built-in internal support by widening the scope of participation.¹³² It's not just a DoD plan, it is the component's plan. By creating standards and focusing direction (telling the components what needs to be done, giving them the standards they need to conform to), but not dictating how it is to be done, the end products should be done better and faster than if one composite plan had been negotiated from scratch.

4. Top Management Support – High Risk

The issue of top management support of the FIAR Plan is very complicated, yet critical to success. The December 2005 FIAR Plan stated, "Senior leaders throughout the Department are committed to implementing the FIAR Plan."¹³³ Which senior leaders are being referred to? The DoD is comprised of three different leadership structures; political, military, and career civilian. Each has different cultures, incentives, and accountability; all experience high rates of turnover.

Evidence supports the notion that the political leadership is behind the Plan. In November 2005, then Acting Deputy Secretary of Defense Gordon

¹³² Sergio Fernandez and Hal Rainey. "Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice" in *Public Administration Review*. (March/April 2006), 11.

¹³³ Defense Financial Improvement and Audit Readiness Plan (December 2005) 16.

England, issued a memorandum concerning the soon-to-be released FIAR Plan. He stated, "Support from every DoD community, both functional and financial, is essential. I expect you to make the development and implementation of this plan a priority so we can realize these benefits as soon as possible." Note that he did personally underline "a priority" when he signed the memo. Congressional testimony and discussions with DoD financial managers seem to confirm that political leadership is indeed supportive of the efforts.

With the resignation of Donald Rumsfeld following the 2006 Congressional elections, the status of political support from within the DoD becomes questionable. It remains to be seen who will stay in their positions and finish the term, and what people in key positions to influence support will leave. It is also uncertain as to how committed the next Secretary of Defense will be to the FIAR Plan and its initiatives.

Support by civilian and military leadership is also questionable. In interviews with financial managers directly associated with implementation of the FIAR Plan, the view was expressed that support among civilian and military leaders does not match that of the political side. This is especially so amongst the uniformed community. The DoD operates in a budget accounting world. As one financial manager said, "...the major focus is on getting money for programs, not tracking how the money is used." As the programs under the FIAR Plan progress, proprietary and managerial accounting capabilities will be added to the working environment. This is going to require a change in how senior managers work and think. Financial managers have noted that there is resistance to that.

In 2009 there will be a new administration in the White House. The appointed leaders of the next administration will have their own agenda they will wish to engage. Financial management reform efforts may or may not be one the priorities. If key DoD civilian and military leaders that will be part of the transition process do not transmit the importance of the FIAR Plan or their desire to keep the program going, then it will likely lose the support required to continue.

The Comptroller General, David Walker, has been campaigning for the DoD to adopt a Chief Management Officer (CMO) to lead the business

transformation efforts for the Department. In the Fernandez/Rainey research, such a person would be referred to as a change agent or idea champion, and studies support the idea that such a person can help lead to a successful change.¹³⁴ Walker suggests that this position be an executive level appointee with a term to last 5 to 7 years. Furthermore, this position, "...would not assume the responsibilities of the undersecretaries of defense, the service secretaries, or other DoD officials for the day-to-day management of the department."¹³⁵

The CMO, as suggested by the GAO, would be a policy maker, not an implementer. Furthermore, a position with a 7-year term would almost guarantee the official would, at some point, function under a different administration or even a different political party. Policy suggested from a CMO which is at conflict with the Secretary of Defense will likely not be implemented due to lack of authority. The risk is that all top management support from those with actual authority would be lost.

5. Build External Support – High Risk

Support from political overseers is another key to making change sustainable in the public sector. As mentioned before, it is from the political side that mandates originate and resources are acquired. Elected officials, both in the executive and legislative sides, have the power to promote the desired change, or kill it.

Congress appears to be supportive at the time. However, members of the Senate Subcommittee on Homeland Security and Governmental Affairs seem to be somewhat skeptical of the timelines published in the FIAR Plan.¹³⁶ How the members of the House and Senate Armed Services Committees, and

¹³⁴ Sergio Fernandez and Hal Rainey. "Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice" in *Public Administration Review*. (March/April 2006), 13.

¹³⁵ GAO, "Department of Defense: Sustained Leadership Is Critical to Effective Financial and Business Management Transformation," *Statement of Comptroller General before Senate Subcommittee on Homeland Security and Governmental Affairs*, GAO-6-1006T (Washington, D.C.: USGAO, 3 August 2006). 23.

¹³⁶ Senate Homeland Security and Governmental Affairs, Federal Financial Management, Government Information and International Security Subcommittee on Financial Management at the Defense Department Hearing (3 August 2006).

Appropriations Committees feel about the FIAR Plan is unknown.¹³⁷ But, it is through those four committees that many of the DoD mandates are generated and resources budgeted. Those committees and their members are also where much of the DoD leadership concentrates its attention. Adequate political support does not necessarily require all of the leadership. Moore states, "...managers do not need political unanimity to have a successful strategy: all they need is enough political support to supply the money, authority, and people required to implement the strategy."¹³⁸ Thus, it is important to ensure buy-in from members of those key committees.¹³⁹

With the 2006 Congressional elections, both houses changed leadership to the Democratic Party. How that will affect political support of the FIAR Plan from Congress is uncertain.

Support from the non-financial leaders amongst the services is questionable. FIAR Plan leaders in the component services generally expressed difficulty in getting military leaders outside of the financial management community to recognize the importance of the financial improvement, its possible benefits, or the state of current financial systems. This is somewhat understandable considering operational leaders and support staff are engaged in fighting an actual war. Non-financial issues tend to take priority. But, these commands are the ones that are actually generating the financial data and making decisions based on those current financial systems which have been called into question. Mark Easton, the Director of the Navy's Office of Financial Operations, sums up the problem many financial managers face, "The financial information that appears on the statements or reports comes from our operations

¹³⁷ There was a hearing conducted by the Senate Armed Services Subcommittee on Readiness and Management Support on 16 November 2006. However, transcripts were not available at time of writing.

¹³⁸ Mark H. Moore, *Creating Public Value: Strategic Management in Government*. Replica Books, Bridgewater, N.J. (1995) 95.

¹³⁹ Sergio Fernandez and Hal Rainey. "Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice" in *Public Administration Review*. (March/April 2006), 14.

– not just from the comptroller.”¹⁴⁰ At a time of increasing financial constraints, increasing operational requirements, and increasing requirements for accountability, everyone in the Department should have a vested interest in seeing improvements made to financial systems and information reporting.

With regard to the previous factor (Top Management Support) and the fact that there will be a change in the executive within the next couple of years, external support can play a major role. Congress and the GAO have the ability to use political pressure to persuade the next administration to sustain the FIAR Plan.

6. Providing Resources – Medium Risk

Significant change is never free. The FIAR Plan is no exception. Billions of dollars are likely to be required over the next several years to see the program through to conclusion. No estimate of the total cost of the FIAR Plan or the component FIPs have been given. \$4.2 billion was budgeted in FY2006 for all DoD transformation programs.¹⁴¹ The December 2005 FIAR Plan stated that funding was sufficient for FY2006 KMPs. Future funding requirements would be addressed through the budget process.

Funding for the FIAR Plan is a little more complicated than the Plan states. The component’s Financial Improvement Plans are funded through their own component budget. While funding was adequate for FY2006 and FY2007¹⁴², there is no guarantee those levels will be maintained for the life of the FIAR Plan. Additionally, the individual components may, at some point in the future, lower the funding priority for their FIAR Plan activities. This would put at risk completion of FIAR Plan elements in a timely manner.

One possible solution discussed with the financial managers was to fund all FIAR Plan KMPs centrally through OSD. Centralized funding would reduce the

¹⁴⁰ Mark Easton, “Business Transformation: The Road to a “Clean” Opinion. How the DON Plans To Sustain Operational Excellence While Maintaining Fiscal Accountability” in *Armed Forces Comptroller*. (Winter 2006) 15.

¹⁴¹ Paul Brinkley, “Taking Business Transformation To The Next Level” in *Armed Forces Comptroller*, (Winter 2006) 10.

¹⁴² Component financial managers did not express concern over FY2007 funding levels following passage of the FY2007 Budget by Congress.

risk that funding would be cut for other component priorities. But, this has inherent risks as well. It essentially removes ownership of the FIAR Plan from the components. With that is the possible loss of internal support of the program. Most of the financial managers felt it was better to keep funding through the component budgets for flexibility and to maintain ownership. It is a trade-off that mitigates risk at the component level, but adds risk to comprehensive change.

7. Institutionalize Change – Medium Risk

The institutionalizing of a change process requires the organization to permanently change its behavior. This is no small task in an organization as large as the DoD. Updating systems and processes is part of the formula for making this happen. But, in the end, the change must be made in the people involved with financial management. And, this includes people that may not see themselves as financial managers.

The FIAR Plan is heavily dependent on the individual components to incorporate changes into their culture. Thus, this factor is subject to the same vulnerability as the others; that individual components lose focus on the Plan, and permanent changes are not incorporated within their organization. Financial visibility for the DoD is reliant on all components and agencies being successful in transformation and efforts and seeing those changes sustained over time.

Fernandez and Rainey make a point that the pace of change is important. But, they do not state with certainty whether changes should come rapidly or incrementally. There is research that supports both methods.¹⁴³ The FIAR Plan makes it clear that this will be an incremental process.¹⁴⁴ Much of that is driven by practical realities. There is much to be done in order to see all DoD financial systems reach a point where they can be audited. There are simply not enough resources available in a short period of time to be applied to the problem and reach a satisfactory conclusion. This is a process which will take time. But, Fernandez and Rainey warn, “Small-scale or gradual implementation may pose

¹⁴³ Sergio Fernandez and Hal Rainey. “Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice” in *Public Administration Review*. (March/April 2006), 16.

¹⁴⁴ Defense Financial Improvement and Audit Readiness Plan (December 2005) 17.

more of challenge in the public sector than in business, since frequent shifts in political leadership and short tenures for political appointees can cause commitment for change to wane.”¹⁴⁵ Again it is worth noting that the FIAR Plan is an 11 year plan developed under an administration that has less than two years left in office. If significant changes are not institutionalized by 2009, the FIAR Plan may come apart in the out-years.

8. Pursue Comprehensive Change – Medium Risk

Fernandez and Rainey refer to comprehensive change as that which brings the subsystems of an organization into alignment.¹⁴⁶ As an enabler of financial management change, this may be a strength of the FIAR Plan. Use of the FIAR Committee, the FIAR Planning Tool, and the FIAR Directorate to coordinate the efforts of the various agencies can help to ensure goals are aligned, and standards are being implemented across the components. Additionally, the FIAR Plan is designed to integrate the efforts made for financial improvements into the other business transformation efforts being undertaken through the BTA.

E. CONCLUSION

The Fernandez/Rainey factors for successful change are not hard and fast requirements. Satisfaction of every factor is no guarantee of success. Likewise, not being able to satisfy them is no guarantee of failure. But, with the backing of the Brook study, it might be inferred that support of top management, internal support, external support, and the provision of resources are the most critical. With that, the evaluation of the risks leads to the conclusion that the FIAR Plan is at a high risk of not being sustainable for the long-term.

Change is not an easy process. Changing the financial systems and processes is going to be a long and difficult task. But, having used the Fernandez/Rainey framework as a model, it becomes obvious that people are an integral part of the change process. Given the extended amount of time people

¹⁴⁵ Sergio Fernandez and Hal Rainey. “Managing Successful Organizational Change in the Public Sector: An Agenda for Research and Practice” in *Public Administration Review*. (March/April 2006), 16.

¹⁴⁶ Ibid.

have been dealing with the issue of financial management reform verified through audited financial statements, and the political realities of an upcoming election, there could be problems making this plan work. The change in people (i.e., the change in culture) needs to come before changes in systems. Due to the large changes that are happening with the political environment, the time for that to take effect is drawing short.

VI. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS FOR FURTHER STUDY

A. SUMMARY

The sequence of events which led to the formation and release of the FIAR Plan in late 2005 is long and complicated. It started over two decades ago a series of laws passed by Congress intended to improve financial management within the federal government. The DoD struggled with compliance. Efforts to improve financial systems and achieve auditability were mainly focused with the individual components.

The Friedman Report of 2001 gave DoD leadership a better understanding of the of the problems associated with financial management within the Department. They also had recommendations to tackle the issues using a comprehensive approach. This led to several initiatives that eventually evolved into the BTA, which is leading the transformation efforts of all of the business areas the Department. Critical to the success of a comprehensive approach was the development of department-wide standards to which the individual components could conform. Standardization programs such as the SFIS are designed to meet those requirements. The FIAR Plan is executed by the USD(C) and is the enabler for DoD transformation with respect to the BTA's Business Enterprise Priority of Financial Visibility.

The FIAR Plan uses a prioritized and incremental approach for financial improvements with collaboration from the DoD components. Priorities are set by the FIAR Committee and the plan is monitored by the FIAR Directorate. It leverages previous work done by continuing to use the component's own financial improvement plans.

The FIAR Plan focuses the efforts of the components through the use of focus areas. These are Military Equipment, Real Property, Medicare-Eligible Retiree Health Care Fund, Environmental Liabilities, Inventory and Operating Materials and Supplies, Accounts Payable, and Accounts Receivable. It also puts

in place a systematic process for the components to use to prepare for their independent audits. According to projections, the DoD should be able to achieve an unqualified opinion on its consolidated statements by 2017.

B. CONCLUSIONS

The use of the academic frameworks provides a different, if not unique, perspective on the evaluation of a DoD program. The Moore Model of public value creation stresses the critical need for a strategy to integrate politics, substance, and administration. These are represented as forces; Up, Out, and Down, respectively. The FIAR Plan does achieve this integration. Summing the findings of value creation:

- Up – It sets the roadmap for compliance with Congressional mandates. It also tracks milestones to demonstrate that progress is being made. The FIAR Plan has been viewed as a positive step by Congress, the GAO, DoD IG, and OMB.
- Out – For the public the FIAR Plan provides a visible demonstration that the DoD is working to improve its financial systems. Eventually, with the unqualified opinion, it will provide an independent assessment that financial processes are working well. The value created is improved confidence in the conduct of the organization. Thus, the auditor's opinion on the financial statements is important. For the DoD components, the financial improvements made will improve the information used for decision making.
- Down – The FIAR Plan adds value for the financial management community by providing a common framework from which to make their improvements. Accountability is more visible across the components with the use of the FIAR Planning Tool and reporting. It also provides the systematic process for preparing for audit.

While the FIAR Plan does create the value, as stated above, there are potential further benefits. These are:

- Working with political leadership to take advantage of future financial visibility;
- Improved visibility to changes in the Plan so overseers have less reason to question the sincerity or execution of the Plan;
- Seeking progress metrics that non-financial managers can understand and appreciate;
- Make the relevance of financial information just as important as the timeliness, accuracy, and reliability of it;

- Including the transformation of financial managers as people to handle the transformation of systems and processes.

The Fernandez and Rainey success factors for change in a public organization offer an opportunity to examine the risk that the change process the FIAR Plan represents could be sustained over the long-term. The eight success factors are:

- Ensure top management commitment;
- Build external support;
- Ensure the need;
- Build internal support;
- Provide resources;
- Institutionalize change;
- Pursue comprehensive change;
- Provide a plan.

Findings indicate that top management support and external support are high risk areas. This is due to the questionable support from non-politically appointed leadership, especially from those with non-financial backgrounds. Additionally, with the upcoming elections in 2008 there is no guarantee that the next administration will have the same priority with regard to financial reform. The effects of the recent 2006 Congressional election are uncertain. Without support from the current civilian and military leadership, the risk of a priority shift increases.

The next five factors were medium risk areas. The FIAR Plan's inclusion of component FIPs helps to ensure support from within and encourage the changes required. But it does risk reprioritization at the component level which could upset the Plan at the macro level.

Using the Brook (2001) study, support of top management, internal support, external support, and the provision of resources are the most critical elements. Efforts focused in these areas would likely have the greatest impact on sustainability. Additionally, these factors require that a focus on people is critical for sustained changes to succeed.

This thesis began by asking two questions. First, does the FIAR Plan create value, in the sense that it helps to meet desires and expectations of stakeholders concerned? This analysis indicates that it does. However, there are opportunities to increase that perceived value to the various stakeholders, as noted above. The Moore Model implies that value creation is an active and not a static process.

To the second question; if it does create value, then can the changes required of the FIAR Plan be sustained over the long-term? This analysis indicates based on the Fernandez/Rainey success factors that there is a considerable amount of risk that it might not. The analysis also showed that there are many elements present that promote sustainability. These include established political mandates, a viable plan which is currently funded, and an improving (although not institutionalized) awareness of the importance and benefits of upgrading financial systems, processes, and people.

It is worth noting that these two elements, value and sustainability, are mutually supportive. Those activities which create value will promote sustainment. Likewise, those activities which ensure sustainment will increase value. This correlation can also be applied to the two models used for this analysis. Moore's UP direction (Political System) matches to the Fernandez/Rainey factors of ensuring the need, external support, comprehensive change and provision of resources. Value created in this direction will aid DoD FM increased political legitimacy and financial support. Interactive involvement with political authorizers can be critical to long-term success as was seen with the New Zealand government's change in accounting systems.¹⁴⁷

Moore's OUT direction (Receivers and Payers of Services) aligns with the Fernandez/Rainey factors of ensuring the need, external support and comprehensive change. It is worth noting again that the root of value is in the perceived desires of the individual. A successful plan requires having knowledge

¹⁴⁷ Joanne Lye, Hector Perera, and Asheq Rahman. "The Evolution of Accruals-Based Crown (Government) Financial Statements in New Zealand." *Accounting, Auditing & Accountability Journal*. (2005), 800.

of what value needs to be created before making the change.¹⁴⁸ An understanding of how these stakeholders use financial information is critical to providing the right value. With that, support will follow.

Moore's DOWN direction (Organization) aligns with the Fernandez/Rainey factors of ensuring the need, providing a plan, internal support, top management support, institutionalize change and comprehensive change. What becomes clearer when combining the two models in this direction is the importance of the human element in creating value and sustained change. Achieving the value potential UP and OUT requires the organization to make sustained changes within itself. This is as much a leadership and education challenge as it is a system and process challenge.

C. RECOMMENDATIONS FOR FURTHER STUDY

One of the near-term objectives in the FIAR Plan is the audit of the Marine Corps financial statements. The Marine Corps is smallest of the uniformed services and it should be the first to go through the FIAR Plan's assertion process for an audit. It is scheduled to go through the Validation Phase in FY07. If successful, they may be able to perform an audit in FY08.¹⁴⁹ As the Marine Corps goes through this process, it provides an opportunity to observe and report on how it does. Such a study may highlight challenges faced which might affect other agencies, and factors for success.

As noted in the findings, the human element (which includes education, training, motivation, incentives, and promotion of innovative thinking) is critical to the success of the FIAR Plan. Further study is warranted into how to incorporate a human capital strategy into the FIAR Plan and FIPs. An unqualified opinion on audits is one step towards achieving relevant financial information. But, it is no guarantee that it will be used. The users of financial information need to be prepared to take advantage of it.

¹⁴⁸ Joanne Lye, Hector Perera, and Asheq Rahman. "The Evolution of Accruals-Based Crown (Government) Financial Statements in New Zealand." *Accounting, Auditing & Accountability Journal*. (2005), 809.

¹⁴⁹ Defense Financial Improvement and Audit Readiness Plan (September 2006) 26.

A detailed analysis of the individual component FIPs was beyond the scope of this study. While the FIAR Plan provides guidance and direction at the top level, it is the responsibility of the components to make the improvements happen. Management challenges are political, fiscal, and very technical in nature. Each of the component FIPs would be topic-rich for future studies. While USD(C) works to ensure the information traveling up through the components is standardized; the methods for achieving that are different among the FIPs. That presents the opportunity for comparative studies. Additionally, there are highly technical problems with systems integration, software configurations, and information flow which can be studied.

As was noted in Chapter IV with the complete Moore Model (Figure 4-5), there are forces outside the direct influence of management, such as informal networks and the media. These forces can either be a vulnerability or an opportunity. Further study, such as the mapping of informal communication and influence networks from the FM community to the various stakeholders might indicate how to exploit these areas. Marketing research into traditional and non-tradition media may help improve communication to stakeholders.

While most of the DoD agencies are still working to obtain unqualified opinions on audit, there are five that have already achieved that mark. They are noted in Chapter III. These agencies might be good candidates for case studies which document the factors which led to their success. Such case studies might provide positive and applicable insights for other agencies to use in their own financial improvement programs.

Among the comments from financial managers in the interviews was an acknowledgment that auditing standards, while stabilizing, continue to change. This has been a challenge for the financial managers to deal with. Changing standards was one of the major issues brought up in the Friedman Report as a barrier to financial improvement.¹⁵⁰ Further investigation was not possible for this study. However, this is a subject that might warrant a closer look. How have changing standards and requirements from FASAB and the GAO affected the

¹⁵⁰ DoD Report, "Transforming Department of Defense Financial Management: A Strategy for Change" (13 April 2001) 4-9.

ability of the DoD to make improvements? What is driving those changes? What issues are left to be resolved? Those are questions that could not be answered for this report, but might have a material impact on how quickly and effectively the DoD is able to attain a full audit.

Financial information is used differently by different stakeholders. Further study is warranted in how stakeholders use financial information. Such a study, or series of studies, would help to identify what is perceived as relevant information for users. This would help to tailor services and programs to maximize the value delivered by financial managers. It would aid in identifying opportunities where education and training might improve how financial information is employed. It would also provide a basis for examining how financial information could be used differently as new financial systems are brought online.

The Moore Model was a useful tool to examine the value to stakeholders of the FIAR Plan. It is a framework which may be helpful for examining other programs, strategies, or organizations within the DoD.

The Fernandez/Rainey factors for successful change offered an interesting framework to assess the long-term sustainability risk of the FIAR Plan. While the factors were derived from previous studies, there is no definition of what constitutes successful achievement of the factor. This is an opportunity for study to derive quantifiable measures that could be applied to the factors. This would make future risk assessments using this model less subjective in nature.

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